SUPREME COURT OF THE UNITED STATES

OCTOBER TERM, 1933

No. 689

GUY T. HELVERING, COMMISSIONER OF INTERNAL REVENUE, PETITIONER

vs.

THE INDEPENDENT LIFE INSURANCE COMPANY

ON WRIT OF CERTIORARI TO THE UNITED STATES CIRCUIT COURT OF APPEALS FOR THE SIXTH CIRCUIT

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[Caption Omitted]

Before United States Board of Tax Appeals

No. 25295

THE INDEPENDENT LIFE INSURANCE CO., PETITIONER,

vs.

COMMISSIONER OF INTERNAL REVENUE, RESPONDENT.

For Taxpayer: James A. Newman, Esq.
For Commissioner: E. C. Lake, Esq.

Docket entries

1927
Mar. 17—Petition received and filed. (2).
Apr. 15—Amended petition filed by taxpayer,
" 18—Copy of amended petition served on General Counsel.
May 25—Answer to amended petition filed by G. C.
" 27—Copy of answer served on taxpayer, Gen. Cal.
1928
Dec. 8—Hearing set Jan. 29, 1929.
1929
Jan. 17—Stipulation of fact filed.
" 24—Motion to amend petition filed by taxpayer, amendment tendered.
" 25—Motion granted.
" 29—Hearing had before Mr. Sternhagen, pet. brief 3-5-29—respondent's 3-25-29—pet. reply 4-11-29.
" 28—Copy of motion and amended petition served on G. C.
Mar. 4—Brief and argument filed by taxpayer (1).
Mar. 22—Brief filed by G. C.
2 Apr. 13—Order extending time for filing petitioner's reply brief, to 4-30-29 entered.
Apr. 15—Reply brief filed by taxpayer. (1).
Oct. 4—Findings of fact and opinion rendered, John M. Sternhagen, Div. 10. Judgment will be entered under rule 50.
" 26—Notice of settlement filed by G. C.
" 31—Hearing set under Rule 50 for Nov. 20, 1929.
Nov. 8—Consent to settlement filed by taxpayer.
" 18—Judgment entered, John M. Sternhagen, Div. 10.
May 13—Petition for review by U.S. Cir. Ct. of Ap. (6) with assignment of error filed by G. C.
" 17—Proof of service filed.
July 14—Motion for extension to Oct. 1, 1930 to prepare and deliver record, filed by G. C.
" 14—Order enlarging time to Oct. 1, 1930 for preparation of evidence and delivery of records sur petition for review, entered.

1929

Oct. 1—Motion for extension of time to 11-15-30 to prepare and deliver record filed by G. C.

" 1—Order enlarging time to Nov. 15, 1930 to prepare and deliver record, entered.

Nov. 5—Statement of Evidence lodged by G. C.

" 15—Motion for enlargement of time to 12-15-30 to prepare and deliver record filed by taxpayer.

" 15—Order enlarging time to Dec. 15, 1930 for preparation and delivery of record, entered.

" 19—Agreed statement of evidence lodged.

" 19—Agreed praecipe filed, proof of service thereon.

" 20—Agreed statement of evidence approved and ordered filed.

Dec. 15—Order entered extending time for filing record to Jan. 31, 1931.

Now, Dec. 13, 1930, the foregoing Docket Entries certified from the record as a true copy.

[SEAL]

B. D. GAMBLE,
Clerk, U.S. Board of Tax Appeals.

3 Before U.S. Board of Tax Appeals

Amended petition

Filed April 15, 1927

Petition of the Independent Life Insurance Company of America, at Nashville, Tennessee, respectfully shows:

I

That it is aggrieved by the ruling of the Commissioner of Internal Revenue at Washington, D.C., involving the matter of a deficiency assessment upon its income for the years 1923 and 1924, the Commissioner having assessed said company upon the income on its building located at Nashville, Tennessee, based upon article 686, Regulation 62, and which said assessment, petitioner respectfully represents and shows, is erroneous and does not represent income as defined by the act but represents and is an arbitrary, false, and improper assessment, and that said regulation is itself in violation of section 245 (b) of the act of February 26, 1926, and all prior revenue acts, which define and provide the method of calculation upon which the assessment should have been made by the Commissioner of Internal Revenue.

On the 30th day of October, 1926, the Commissioner of Internal Revenue made a deficiency assessment against petitioner herein in the sum of $4,926.43, to which protest was duly and seasonably made, and thereafter, on the 25th day of January, 1927, a final assessment by the Commissioner was made, as above shown, and petitioner notified thereof, said assessment showing a deficiency of $1,414.62.

Thereafter and on the 11th day of March, 1927, and within sixty days after the deficiency assessment by the Commissioner of Internal Revenue, a petition was addressed to this honorable Board by petitioner herein and duly filed, and which is now filed and pending undetermined before this honorable Board. No answer has been filed to said petition, and petitioner herein is advised that the same is not in proper form, and it therefore brings this amended and supplemental petition, conforming to the requirements of the Board asking leave to file the same, and it hereby refers to and makes its said petition filed herein on March 11th part and parcel
4 hereof by a reference thereto, the same as if it were copied herein in its entirety and made verbatim a part of this petition.

The original letter, together with the Commissioner's assessment, is attached hereto, marked "Exhibit No. 1" to this petition, and shows the basis upon which said assessment was made.

II

The deficiency for which said assessment was made, as shown by exhibit no. 1 attached, is $298.97 for the year 1923 and $1,115.65 for the year 1924, a total deficiency of $1,414.62.

III

Petitioner assigns as error to the ruling of the Commissioner, the following:

(a) The Commissioner erred in basing the assessment upon article 686 of Regulation 62, which is in violation of section 245 (b) of the Revenue Act of February 26, 1926, and prior revenue acts.

(b) Section 245 (b) of the Revenue Act of February 26, 1926, provides that if deductions for expenses are made for the operation of any building owned and occupied in whole or in part, by a life insurance company, then the rental value of the space occupied by such company shall be fixed at a sum to provide a net income on such space equal to 4% of its book value at the end of the taxable year, while the Commissioner in his ruling and in his deficiency assessment under said article 686, of Regulation 62, has so computed the tax on the space occupied by petitioner as to make said space return a net income of 4% on the book value of the entire building at the end of the taxable year.

(c) Said article 686 of Regulation 62 is in violation of section 245 (b) of the Revenue Act of February 26, 1926, in that said revenue act provides that the space occupied by a life insurance company shall, in addition to other rents received, be calculated at a value to pay or show a net income of 4% on the book value of such space, at the end of the taxable year, while article 686 of
5 Regulation 62 provides that the space so occupied by a life insurance company shall be placed at such a value as will, together with other rents received from tenants, pay 4% on the

total valuation of the building so occupied by such insurance company, and the Commissioner of Internal Revenue has assessed petitioner under said article 686 of Regulation 62, and therefore in violation of section 245 (b) of the Revenue Act of February 26, 1926.

(d) Section 245 (b) of the Revenue Act of February 26, 1926, is to provide income upon space occupied by a life insurance company in its own building whenever deductions or credits are claimed, and such income is to pay 4% upon the book value of such space, and which shall be added to the rents received from other tenants, and the two together represent the income on such building from which such expenses are then to be deducted. Said article 686 of Regulation 62 provides a method, which, together with rents received from other tenants, will provide the net income of 4% on the entire building so occupied by such insurance company at its book value, at the end of the taxable year, over and above any expenses for the operation of such building and irrespective of the amount of such expenses, said article 686 of Regulation 62 thus providing an arbitrary income on any building occupied by said insurance company of 4% on its said book value in any and all offices, and thus constituting a direct tax on such real estate and not an income tax, as provided by said section 245 (b) of said Revenue Act.

(e) The Independent Life Insurance Company of America only occupies less than one entire floor in a twelve-story building, and yet the assessment as calculated by the Commissioner of Internal Revenue fixes the value of the said space at such a figure as to pay 4% income on the book value of the entire building.

(f) Article 686 of Regulation 62 and the action of the Commissioner of Internal Revenue thereunder, operates as a prohibition of life insurance companies from receiving credit for the expenses which they are allowed to deduct under section 245 (a) (6) and (7) of said Revenue Act of February 26, 1926, and makes said sections of said Revenue Act nugatory and void.

6 (g) The Commissioner erred in not allowing a credit as against the assessment made by him for the loss sustained in 1922 as against his assessment for the years 1923 and 1924, and which said loss is a credit to which petitioner was entitled, the loss for the year 1922 being the sum of $19,009.95.

IV

Petitioner would now show that it is a life insurance company owning a twelve-story building on the corner of Fourth Avenue North and Church Street in the city of Nashville, Davidson County, Tennessee, and that it occupies less than one floor of said building for its insurance offices. For the year 1922 it showed a net loss for the operation of its said building of $19,009.95, exclusive of an amount paid for damages as a result of an elevator accident in the sum of $15,614.18, or a total loss for said year of $34,624.13.

The book value for the year 1923 of the building which it occupies was fixed at $460,000.00 and the book value for the year 1924 of

said building was fixed at $494,257.97. The expenses of operation of said building for the year 1923 as allowed by the Commissioner are $70,005.18, and for 1924 $85,918.97. The Commissioner has accordingly fixed the value of the same identical space occupied by the company as its offices for the year 1923 at $14,784.70, and for 1924 at $34,400.08, while petitioner insists that the book value of the space so occupied by it should not be exceeding one twelfth of the book value of said building for each of said years, and that it should only be required to pay, in addition to the rents received from other tenants, 4% on such book value of the space which it occupies. The rents received from other tenants for the year 1923 was $73,620.48, and the net income from other tenants above expenses, $3,615.30. For the year 1924 the rents received from other tenants was only $71,281.21, a net loss of actual rents received as compared with the expenses for that year of $14,629.76. The Commissioner accordingly figures the value of the space for the year 1924 at such a sum
7 as shall compel petitioner to pay 4% on the book value of said building irrespectively.

V

Wherefore, petitioner prays:

(1) That it be granted a redetermination of the amount of the alleged deficiency and that the action of the Commissioner of Internal Revenue be reversed and revoked;

(2) That it be given all such other, further and general relief as it may be entitled to at the hearing.

INDEPENDENT LIFE INS. CO.
By PAUL ROBERT, *Pres.*

[*Duly sworn to by Paul Roberts, jurat, omitted in printing.*]

8

TREASURY DEPARTMENT,
OFFICE OF COMMISSIONER OF INTERNAL REVENUE,
Washington, Jan. 25, 1927.

IT:CA:2553-9-60D
INDEPENDENT LIFE INSURANCE COMPANY,
Independent Life Bldg.,
Corner Fourth and Church Streets,
Nashville, Tennessee.

SIRS: The determination of your income-tax liability for the years 1923 and 1924, as set forth in office letter dated October 30, 1926, has been changed as the result of your letter dated November 26, 1926, to disclose a deficiency in tax amounting to $1,414.62, as shown in the attached statement.

In accordance with the provisions of section 274 of the Revenue Act of 1926, you are allowed 60 days from the date of mailing of this letter within which to file a petition for the redetermination of this deficiency. Any such petition must be addressed to the United States Board of Tax Appeals, Earle Building, Washington, D.C., and must be mailed in time to reach the Board within the 60-day period, not counting Sunday as the sixtieth day.

Where a taxpayer has been given an opportunity to file a petition with the United States Board of Tax Appeals and has not done so within the 60 days prescribed and an assessment has been made, or where a taxpayer has filed a petition and an assessment in accordance with the final decision on such petition has been made, the unpaid amount of the assessment must be paid upon notice and demand from the Collector of Internal Revenue. No claim for abatement can be entertained.

If you acquiesce in this determination and do not desire to file a petition with the United States Board of Tax Appeals, you are requested to execute a waiver of your right to file a petition with the United States Board of Tax Appeals on the inclosed form A, and forward it to the Commissioner of Internal Revenue, Washington, D.C., for the attention of IT:CA:2553-9-60D. In the event that you acquiesce in a part of the determination, the waiver should be executed with respect to the items to which you agree.

9

Respectfully,

D. H. BLAIR,
Commissioner.
By C. R. NASH,
Assistant to the Commissioner.

Inclosures: Statement; form A; form 882.

STATEMENT

IT:CA:2553-9-60D.

In re: Independent Life Insurance Company, Independent Life Building, Corner Fourth and Church Streets, Nashville, Tenn.

Year:	Deficiency in tax
1923	$298.97
1924	1,115.65
Total	1,414.62

1923

Income:		
Interest from all sources		$19,704.81
Rents		88,405.18
Gross income		108,109.99
Deductions:		
Interest exempt	$1,948.32	
Excess of 4% of means of reserve over exempt interest	20,363.33	
Investment expenses	1,946.00	
Taxes	11,147.72	
Other real estate expenses	51,357.46	
Depreciation	7,500.00	
Interest	8,552.48	
Total deductions		102,815.31
Adjusted net income		5,294.68

In connection with the above adjustment of gross income with respect to rents, your attention is invited to Article 686, Regulations 62, which reads in part as follows:

10 "No deduction shall be made for any taxes, expenses, or depreciation on account of any real estate owned or occupied in whole or in part by a life insurance company unless there is included in the return of gross income the rental value of the space so occupied, such rental value shall not be less than a sum which in addition to any rents received from other tenants shall provide a net income (after deducting taxes, depreciation, and other expenses) at the rate of 4 percent per annum of the book value at the end of the taxable year on the real estate so owned and occupied."

Book value of home office			$460,000.00
Rents received from other tenants		$73,620.48	
Less:			
Expenses	$51,357.46		
Taxes (on R. E.)	11,147.72		
Depreciation	7,500.00		
		70,005.18	
		3,615.30	
Less: 4% of $460,000		18,400.00	
Value of space owned and occupied by company to be included in gross income			14,784.70
Rents from other tenants in building in which company occupied space			73,620.48
Total rents to be reported in gross income			88,405.18

You are advised that the amount, $11,376.81, representing permanent improvements, has been eliminated from expenses in accordance with section 245 (a) (6) of the Revenue Act of 1921.

COMPUTATION OF TAX

Net income	$5,294.68	
Less: Exemption	2,000.00	
Taxable at 12½%	3,294.68	
Tax at 12½%		$411.83
Previously assessed		112.86
Deficiency in tax		298.97

1924

Income:			
Interest from all sources			20,519.85
Rents			105,689.29
Gross income			126,209.14
11 Deductions:			
Interest exempt	$1,687.81		
Excess of 4% of means of reserve over exempt interest	22,773.76		
Investment expenses	2,220.34		
Taxes	11,147.00		
Other real-estate expenses	67,271.97		
Depreciation	7,500.00		
Interest	868.69		
Total deductions			113,569.57
Adjusted net income			$12,739.57

The adjustment for rents is made for the same reasons as given in 1923. The computation is as follows:

Book value of home office			$494,257.97
Rents received from other tenants		$71,289.21	
Less:			
Expenses	$67,271.97		
Taxes (on R. E.)	11,147.00		
Depreciation	7,500.00		
		85,918.97	
		14,629.76	
Add: 4% of $494,257.97		19,770.32	
Value of space owned and occupied by company to be included in gross income			$34,400.08
Rents from other tenants in building in which company occupied space			71,289.21
Total rents to be included in gross income			$105,689.29

COMPUTATION OF TAX

Net Income	$12,739.57
Less: Exemption	2,000.00
Taxable at 12½%	$10,739.57
Tax at 12½%	$1,342.44
Previously assessed	226.79
Deficiency in tax	$1,115.65

Your return for the year 1922 has been closed, showing no tax liability.

12 You are advised that the contentions contained in your letter dated November 26, 1926, have been allowed with the exception of permanent improvements included in expenses for 1923.

Payment of the tax should not be made until a bill is received from the Collector of Internal Revenue for your district, and remittance should then be made to him.

TREASURY DEPARTMENT,
OFFICE OF COMMISSIONER OF INTERNAL REVENUE,
Washington, Oct. 30, 1926.

IT:CA:2353-9.

INDEPENDENT LIFE INSURANCE COMPANY,
Independent Life Building,
Corner Fourth and Church Streets, Nashville, Tennessee.

SIRS: An audit of your income-tax returns for the years 1922, 1923, and 1924 discloses a deficiency in tax amounting to $4,926.43, as shown in the attached statement.

You are granted 30 days from the date of this letter within which to present a protest against the deficiency proposed herein. The protest and any additional statements of facts must be executed in triplicate, under oath, and contain the following information:

(a) The name and address of the taxpayer (in the case of an individual the residence, and in case of a corporation the principal

office or place of business); (b) in the case of a corporation the name of the State of incorporation; (c) the designation by date and symbol of the letter advising of the proposed deficiency with respect to which the protest is made; (d) the designation of the year or years involved and a statement of the amount of tax in dispute for each year; (e) an itemized schedule of the findings to which the taxpayer takes exception; (f) a summary statement of the grounds upon which the taxpayer relies in connection with each exception; and (g) in case the taxpayer desires a hearing, a statement to that effect.

If a protest is filed, any additional evidence or briefs of argument submitted will be given careful consideration, and if the
13 Commissioner finally determines that there is a deficiency, you will be advised thereof by registered mail in accordance with the provisions of section 274 of the Revenue Act of 1926. Should you not agree to the deficiency as finally determined by the Commissioner, you will be allowed 60 days from the mailing of the registered letter in which to file a petition with the United States Board of Tax Appeals for a redetermination of the deficiency.

If you acquiesce in the proposed deficiency as shown in this letter and the accompanying statement, you are requested to execute a waiver of your right to file a petition with the United States Board of Tax Appeals on the enclosed form A, and forward it to the Commission of Internal Revenue, Washington, D.C., for the attention of IT:CA:2553–9. In the event that you acquiesce in a part of such deficiency, the waiver should be executed with respect to the items to which you agree.

Respectfully,

C. R. NASH,
Assistant to the Commissioner.
By F. R. CLUTE,
Head of Division.

Enclosure: Statement; Waiver—Form A. Ford 882.

STATEMENT

IT:CA:2553–9

In re: Independent Life Insurance Company, Independent Life Building, Corner Fourth and Church Streets, Nashville, Tennessee.

Years	Deficiency in tax
1922	$162.66
1923	2,730.17
1924	2,033.06
Total	$4,926.43

1922 ADJUSTMENTS TO INCOME

Net loss reported		$5,294.00
Add:		
1. Taxes deducted on return	$10,574.00	
Amount allowed	6,250.00	
		$4,324.00

Add:			
14 2. Other real estate expenses	$43,798.50		
Amount allowed	39,993.62		
		$3,804.88	
3. Depreciation deducted	$6,466.40		
Amount allowed	5,000.00		
		1,466.40	
Total		9,595.28	
Less: 4. Error in addition		1,000.00	
			$8,595.28
Adjusted net income			$3,301.28

EXPLANATION OF ADJUSTMENTS TO INCOME

1. You are advised that capital stock tax is not an allowable deduction in accordance with section 245(a) (6) of the Revenue Act of 1924.

2. Other real-estate expenses have been adjusted to agree with your report as rendered to the Insurance Department of the State of Tennessee.

3. Depreciation claimed on truck has been disallowed in accordance with section 245(a) (7) of the Revenue Act of 1924.

4. Gross income as shown on return as $78,384.77, whereas the correct amount is $77,384.77.

COMPUTATION OF TAX

Net income	$3,301.28
Less: Exemption	2,000.00
Taxable at 12½%	$1,301.28
Tax at 12½%	162.66
Previously assessed	None
Deficiency in tax	$162.66

1923, ADJUSTMENTS TO INCOME

Net income reported			$2,902.94
Add:			
(1) Taxes deducted on return	$11,147.72		
Amount allowed	6,793.60		
		$4,354.12	
(2) Other real estate expenses deducted on return	51,357.46		
Amount allowed	34,695.92		
		16,661.54	
15 (3) 4% of the mean of reserve over exempt interest	$20,443.33		
Amount allowed	20,363.33		
		80.00	
(4) Interest on indebtedness deducted	$10,302.48		
Amount allowed	8,552.48		
		1,750.00	
			22,845.66
Total			$25,748.60
(5) Error in subtraction on return			1,000.00
Adjusted net income			$24,748.60

EXPLANATIONS OF ADJUSTMENTS TO INCOME

(1) and (2) The adjustments 1 and 2 are made for the same reason as given in 1922.

(3) It is noted that under item 1 of schedule C, as at the beginning of taxable year, you show an amount of $520,575.56, whereas the correct amount is $516,575.72.

(4) You are advised that accrued interest is not an allowable deduction.

(5) On return you show the difference between the total of gross income $99,048.25 and total of deductions $97,143.31, as $2,902.94, whereas the correct amount is $1,902.94, error of $1,000.00.

COMPUTATION OF TAX

Net income adjusted		$24,748.60
Less: Exemption		2,000.00
Taxable at 12½%		$22,748.60
Tax at 12½%		$2,843.57
Previously assessed		112.86
Deficiency in tax		$2,730.71

1924, ADJUSTMENTS TO INCOME

Net income reported on return			$3,814.59
Add:			
16 (1) Taxes deducted on return	$11,147.00		
Amount allowed	9,148.87		
			1,998.13
(2) Other real estate expenses deducted on return	$55,492.93		
Amount allowed	41,226.84		
			14,266.09
Adjusted net income			$20,078.81

(1) and (2) The above adjustments are made for the same reason as given for 1922.

COMPUTATION OF TAX

Net income	$20,078.81
Less: Exemption	2,000.00
Taxable at 12½%	$18,078.81
Tax at 12½%	$2,259.85
Previously assessed	226.79
Deficiency in tax	$2,033.06

Payment of the tax should not be made until a bill is received from the collector of internal revenue for your district, and remittance should then be made to him.

Now, Dec. 13, 1930, the foregoing amended petition certified from the record as a true copy.

[SEAL] B. D. GAMBLE,
Clerk, U. S. Board of Tax Appeals.

17 Before U.S. Board of Tax Appeals

Answer to amended petition

Filed May 25, 1927

The Commissioner of Internal Revenue, by his attorney, A. W. Gregg, general counsel, Bureau of Internal Revenue, for answer to amended petition of the above-named taxpayer, admits and denies as follows:

(1) Admits the allegations contained in paragraph II of the petition.

(2) Denies the respondent erred in the determination of the tax liability of the petitioner for the years 1922 and 1923.

(3) For lack of information upon which to form a belief, denies the allegations contained in the paragraphs under item IV of the petition.

(4) Denies generally and specifically each and every allegation of the petition not hereinbefore admitted, qualified, or denied.

Wherefore, it is prayed that the appeal be denied.

A. W. GREGG,
General Counsel,
Bureau of Internal Revenue.

Of counsel:
GRANVILLE S. BORDEN,
Special Attorney,
Bureau of Internal Revenue.

Now, Dec. 13, 1930, the foregoing answer to amended petition certified from the record as a true copy.

[SEAL] B. D. GAMBLE,
Clerk, U.S. Board of Tax Appeals.

Before U.S. Board of Tax Appeals

Motion for leave to amend petition

Filed Jan. 24, 1929. Granted Jan. 25, 1929

B. H. LITTLETON,
Member, U.S. Board of Tax Appeals.

Your petitioner, The Independent Life Insurance Company of America, an insurance corporation existing under the laws of
18 the State of Tennessee, with its principal office and place of business at Nashville, respectfully moves the Court for an order authorizing and permitting it to amend its petition heretofore filed in this cause, for the following reasons and in the following particulars and manner, to wit:

I

Your petitioner shows at the time of the preparation of its petition herein by counsel, but a short time remained within which to file the same and it was prepared in great haste, and that thereunder petitioner sought and undertook to raise the invalidity of the deficiency assessment by reason of the fact that the rules and regulations of the Commissioner and the Treasury Department under which the same was made was in violation of the provisions of the revenue act under which the income tax was payable and that if not, but in conformity therewith, then the said provisioins of the income tax law under which the tax was levied and collected was in violation of the provisions of the Constitution of the United States prohibiting direct taxes except by apportionment among the States, but in assisigning errors in said petition the revenue act referred to was that of February 26, 1926; when it should have been to the Revenue Acts of 1921 and 1924, the reficiency assessment covering the income tax for the year 1923 and 1924. And, under one of the assignments of error by which the question of the constitutionality of the act was sought to be tested, on the ground of constituting a direct tax and not income tax, the assignment was made in general terms and not specifically.

Inasmuch, therefore, as the questions raised by petitioner are ones of law and not of fact, and for the above reasons, petitioner desires leave to make amendments to its petition in such manner and form as to assign errors in conformity with the above, and accompanies this motion with its proposed amendment.

Wherefore, your petitioner moves the Court that it be granted an order allowing it to file its said amendment to its petition heretofore filed in the cause, amending said petition in
19 conformity therewith, and that if required, a date for hearing of this mot'on be set and a copy hereof be served upon the Commissioner.

A copy of the motion and amendment has been forwarded to the Commissioner by registered mail on the 22nd day of January 1929.

Respectfully,

INDEPENDENT LIFE INSURANCE CO. OF AMERICA,
By JAMES A. NEWMAN, *Solicitor.*

JAMES A. NEWMAN,
Solicitor for Petitioner.

Now, Dec. 13, 1930, the foregoing motion to amend petition and order granting same certified from the record as a true copy.

[SEAL] B. D. GAMBLE,
Clerk, U.S. Board of Tax Appeals.

Before U.S. Board of Tax Appeals

Amendment to petition

Filed Jan. 25, 1929

That section III of pages 3 to 6, inclusive, of the petition, be amended so as to change the reference in subsections (a) to (f), both inclusive, from section 245(b) of the Revenue Act of February 26, 1926, in all cases where said references occur, to sections 243, 244, and 245 of the Revenue Act of November 23, 1921, and said sections of the Revenue Act of June 2, 1924, and by adding to said section III of the petition the following additional assignments of error:

(h) Subsection (b) of section 245 of the Revenue Acts of 1921 and 1924, insofar as the same provides that in determining the rental value of space occupied by an insurance company in a building owned by it in that "such rental value shall be not less than a sum which, in addition to any rents received from other tenants, shall provide a net income (after deducting taxes, depreciation, and all other expenses), at the rate of four per centum per annum of the book value at the end of the taxable year of the real estate so owned or occupied", is in violation of section 243 of the Revenue Act of 1921 and 1924, in that it constitutes a tax not based upon net income.

(i) Section 245 of the Revenue Acts of 1921 and 1924 constitutes a tax upon the gross income from rents of an insurance company and not a tax upon the net income thereof, as provided in section 243 of said acts.

(j) Subsection (b) of section 245 of the Revenue Acts of 1921 and 1924 is in violation of article I, section 9, clause 4 of the Constitution of the United States, which provides that "no capitation or other direct tax shall be laid unless in proportion to the census or enumeration herein before directed to be taken", in that under said clause of said section of these acts a direct tax is laid upon the property of an insurance company.

(k) Subsection (b) of section 245 of the Revenue Acts of 1921 and 1924 is in violation of article I, section 2, clause 3 of the Constitution of the United States, which provides that "Representatives and direct taxes shall be apportioned among the several States which may be included within its Union, according to their respective numbers, which shall be determined by adding to the whole number of free persons, including those bound to service for a term of years, and excluding Indians not taxed, three fifths of all other persons", in that the taxes levied under said section and subsection of said revenue acts was not upon the basis of apportionment in conformity with the Constitution of the United States.

(1) That subsection (b) of section 245 of the Revenue Acts of 1921 and 1924 imposes a tax upon the income of insurance companies and derived from rents of its property, when owned or occupied in whole or in part by it, either upon the gross income and not net income, as provided by section 243 of said acts, or is a direct tax upon the property of insurance companies, in violation of article I, section 9, clause 4, and article I, section 2, clause 3, of the Constitution of the United States.

Respectfully submitted this 22nd day of January 1929.

INDEPENDENT LIFE INSURANCE CO. OF AMERICA,
By JAMES A. NEWMAN.

JAMES A. NEWMAN,
Solicitor for petitioner,
1205 Independent Life Bldg., Nashville, Tennessee.

Now, Dec. 13, 1930, the foregoing amendment to petition certified from the record as a true copy.

B. D. GAMBLE,
Clerk, U.S. Board of Tax Appeals.

Before U.S. Board of Tax Appeals

Findings of fact and opinion

Docket No. 25295. Promulgated October 4, 1929

1. Section 245 (b) denies to an insurance company any deduction for taxes, expenses, and depreciation on account of real estate owned and occupied by it in whole or in part, unless the rental value of the space so occupied is included in gross income, and provides "such rental value shall be not less than a sum which in addition to any rents received from other tenants shall provide a net income (after deducting taxes, depreciation, and all other expenses) at the rate of 4 per centum per annum of the book value at the end of the taxable year of the real estate so owned or occupied." Held, that th' 4 percent minimum must be computed upon the book value of the entire building rather than the value of the space occupied by the company.

2. Because the statutory definition of gross income of life insurance companies in section 244 includes only interest, dividends, and rents, no other factors of gross income may be considered as part of the net income in determining the validity of tax thereon.

3. The Board has authority to consider and decide an issue, properly raised, of the constitutionality of a provision of the revenue act in determining the validity of a deficiency determined by the Commissioner.

4. The rental value of real estate occupied by the owner is not income under the sixteenth amendment, and a tax thereon is not an

income tax but a direct tax upon the real estate which, without apportionment, is unconstitutional.

5. A requirement that, unless rental value of real estate occupied by the owner be included in gross income in computing taxable net income, no deductions shall be made of taxes, expenses, and depreciation in respect of real estate, is invalid. National Life Insurance Co. v. United States, 277 U.S. 508.

6. A requirement that, in computing taxable net income, rental value shall be so computed as to result in a percentage minimum net rental upon the value of the real estate of the taxpayer irrespective of the actual net income or loss therefrom, renders the tax therein a direct tax upon the realty itself and not upon income; and, without apportionment, such a tax is unconstitutional.

7. The use, in computing such minimum net rental, of "book value" as the basis of the percentage to be used in computing taxable net income, renders the tax a direct tax upon something other than income; and, without apportionment, unconstitutional.

James A. Newman, Esq., for the petitioner.

E. C. Lake, Esq., for the respondent.

23 *Opinion*

STERNHAGEN: The Commissioner notified petitioner of a determination of deficiencies in income tax of $298.97 for 1923 and $1,115.65 for 1924. Petitioner attacks this determination as contrary to the Revenue Act of 1921, sections 242 et seq., and similar sections of the Revenue Act of 1924, and, if necessary, contrary to the Constitution.

The facts are presented in the following stipulation:

It is hereby stipulated and agreed by and between the parties to the above-entitled appeal, by their respective counsel:

(1). That the petitioner, Independent Life Insurance Company of America, is a life insurance company, with its home office located at Nashville, Tennessee.

(2). That on January 25, 1927, the respondent mailed to the petitioner a notice of deficiency, showing proposed deficiencies for the calendar years 1923 and 1924 in the amounts of $298.97 and $1,115.65, respectively. A copy of said notice of deficiency is attached hereto as exhibit A, it being agreed that the book value of petitioner's building for the years 1923 and 1924 and the amounts shown therein as rents received from other tenants covering space occupied by others than the company are correct and the facts in this case.

(3) That during the years 1923 and 1924 the petitioner owned a twelve-story building located in the city of Nashville, Tennessee. The petitioner in 1923 and 1924 occupied about one story of said building as its home office and rented such portions of the remainder of the building as it was able to secure tenants for.

EXHIBIT A

INDEPENDENT LILE INSURANCE COMPANY, JAN. 25, 1927.
Independent Life Building,
Corner Fourth and Church Streets, Nashville, Tennessee.

SIRS: The determination of your income-tax liability for the years 1923 and 1924, as set forth in office letter dated October 30, 1926, has been changed as the result of your letter dated November 26, 1926, to disclose a deficiency in tax amounting to $1,414.62, as shown in the attached statement.

STATEMENT

IT:CA:2553-9-60D

In re: Independent Life Insurance Company, Independent Life Building, Corner Fourth and Church Streets, Nashville, Tennessee

Years:	Deficiency in tax
1923	$298.97
1924	1,115.65
Total	$1,414.62

1923

Income:		
Interest from all sources		$19,704.81
Rents		88,405.18
Gross income		$108,109.99
Deductions:		
Interest exempt	$1,948.32	
Excess of 4% of mean of reserve over exempt interest	20,363.33	
Investment expenses	1,946.60	
Taxes	11,147.72	
Other real estate expenses	51,357.46	
Depreciation	7,500.00	
Interest	8,552.48	
Total deductions		$102,815.31
Adjusted net income		$5,294.68

In connection with the above adjustment of gross income with respect to rents, your attention is invited to article 686, Regulations 62, which reads in part as follows:

"No deduction shall be made for any taxes, expenses, or depreciation on account of any real estate owned or occupied in whole or in part by a life insurance company unless there is included in the return of gross income the rental value of the space so occupied, such rental value shall not be less than a sum which in addition to any rents received from other tenants shall provide a net income (after deducting taxes, depreciation and other expenses) at the rate of 4 percent per annum of the book value at the end of the taxable year on the real estate so owned and occupied."

25	Book value of home office		$460,000.00
	Rents received from other tenants	$73,620.48	
	Less:		
	Expenses	$51,357.46	
	Taxes (on R.E.)	11,147.72	
	Depreciation	7,500.00	
		70,005.18	
		$3,615.30	
	Less: 4% of $460,000.00	18,400.00	
	Value of space owned and occupied by company to be included in gross income		$14,784.70
	Rents from other tenants in building in which company occupied space		73,620.48
	Total rents to be reported in gross income		$88,405.18

You are advised that the amount, $11,376.81, representing permanent improvements, has been eliminated from expenses in accordance with section 245 (a) (6), of the Revenue Act of 1921.

COMPUTATION OF TAX

Net income	$5,294.68	
Less: Exemption	2,000.00	
Taxable at 12½%	$3,294.68	
Tax at 12½%		$411.83
Previously assessed		112.86
Deficiency in tax		$298.97

1924

Income:		
Interest from all sources		$20,519.85
Rents		105,689.29
Gross income BS:3		$126,209.14
Deductions:		
Interest exempt	$1,687.81	
Excess of 4% of mean of reserve over exempt interest	22,773.76	
Investment expenses	2,220.34	
Taxes	11,147.00	
Other real estate expenses	67,271.97	
Depreciation	7,500.00	
Interest	868.69	
Total deductions		$113,469.57
Adjusted net income		$12,739.57

26 The adjustment for rents is made for the same reason as given in 1923. The computation is as follows:

	Book value of home office		$494,257.97
	Rents received from other tenants	$71,289.91	
	Less:		
	Expenses	$67,271.97	
	Taxes (on R.E.)	11,147.00	
	Depreciation	7,500.00	
		85,918.97	
		$14,629.76	
	Add: 4% of $494,257.97	19,770.32	

Value of space owned and occupied by company to be included in gross income	$34,400.08
Rents from other tenants in building in which company occupied space	71,289.21
Total rents to be included in gross income	$105,689.29

COMPUTATION OF TAX

Net income	$12,739.57
Less: Exemption	2,000.00
Taxable at 12½%	$10,739.57
Tax at 12½%	1,342.44
Previously assessed	226.79
Deficiency in tax	$1,115.65

Your return for the year 1922 has been closed, showing no tax liability.

You are advised that the contentions contained in your letter dated November 26, 1926, have been allowed with the exception of permanent improvements included in expenses for 1923.

Payment of the tax should not be made until a bill is received from the collector of internal revenue for your district, and remittance should then be made to him.

Insurance companies, including domestic life companies, are subject to a special method of income tax, which is set forth in title II, Revenue Acts of 1921 and 1924, beginning with section 242. National Life Insurance Co. v. United States, 277 U.S. 508; Metropolitan Life Insurance Co., 8 B.T.A. 938; John Hancock Mutual Life Insurance Co., 10 B.T.A. 836; Midland National Life Insurance Co., 14 B.T.A. 200.[1]

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The principal characteristic of this special method is that, instead of defining gross income broadly, as is done in section 233 in respect

[1] An explanation of the special scheme is found in the testimony on September 6, 1921, of Dr. Thomas S. Adams, tax adviser, Treasury Department, before the Senate Committee on Finance, 67th Congress, during its consideration of H.R. 8245, which became the Revenue Act of 1921. Hearings, pages 83 to 95, inclusive. The report of the House Committee on Ways and Means is as follows:

LIFE INSURANCE COMPANIES

Sections 242–246: The provisions of the present law applicable to life insurance companies are imperfect and productive of constant litigation. Moreover, the taxes paid by life insurance companies under the income tax are inadequate. It is accordingly proposed in lieu of all other taxes to tax life insurance companies on the basis of their investment income from interest, dividends, and rents, with suitable deductions for expenses fairly chargeable against such investment income. The new tax would yield a larger revenue than the taxes which it is proposed to replace.

The report of the Senate Committee on Finance is as follows:

TAXES ON LIFE INSURANCE COMPANIES

Sections 242–246 provide a new plan for the taxation of life insurance companies, substantially similar to the plan embodied in the Revenue Act of 1918 as first adopted by the Senate. The provisions of the present law applicable to life insurance companies are imperfect and productive of constant litigation. The proposed plan would tax life insurance companies on the basis of their investment income from interest, dividends, and rents, with suitable deductions for expenses fairly chargeable against such investment income. The new tax would take the place of the present income and excess-profits taxes for the year 1921, and life insurance companies would share with other
28 insurance companies in the repeal in the year 1922 of the capital stock tax and the taxes imposed by section 503. The new tax will yield a larger revenue than the taxes which it is proposed to replace.

See also Holmes, Federal Taxes, Sixth Edition, p. 317, et seq.; Montgomery, Income Tax Procedure, 1927, ch. 44; Foulke, The Federal Income Tax, ch. 38.

of other corporations generally, it adopts a special definition which includes only so-called "investment income" consisting of interest, dividends, and rents, and excludes all other income, such as premium receipts and profits from sales of securities or other assets. The tax is levied at the same percentage of defined net income as is applied by section 230 to other corporations. Net income is defined as gross income less specified items described in nine subdivisions of section 245, subsection (a). Of these deductions, only (6) and (7) are important in this proceeding; and the material parts thereof, together with subsection 245 (b), are as follows:

(6) Taxes and other expenses paid during the taxable year exclusively upon or with respect to the real estate owned by the company, not including taxes assessed against local benefits of a kind tending to increase the value of the property assessed, and not including any amount paid out for new buildings, or for permanent improvements or betterments made to increase the value of any property. ***

(7) A reasonable allowance for the exhaustion, wear and tear of property, including a reasonable allowance for obsolescence. ***

* * * * * * *

(b) No deduction shall be made under paragraphs (6) and (7) of subdivision (a) on account of any real estate owned and
29 occupied in whole of in part by a life insurance company, unless there is included in the return of gross income the rental value of the space so occupied. Such rental value shall be not less than a sum which in addition to any rents received from other tenants shall provide a net income (after deducting taxes, depreciation, and all other expenses) at the rate of 4 per centum per annum of the book value at the end of the taxable year of the real estate so owned or occupied.

Regulation 62, under the Revenue Act of 1921 and Regulations 65 under the Revenue Act of 1924 contain the following article:

"ART. 686. Home office properties.—No deduction shall be made for any taxes, expenses, or depreciation on account of any real estate owned and occupied in whole or in part by a life insurance company unless there is included in the return of gross income the rental value of the space so occupied. Such rental value shall not be less than a sum which in addition to any rents received from the other tenants shall provide a net income (after deducting taxes, depreciation, and other expenses) at the rate of 4 percent per annum of the book value at the end of the taxable year of the real estate so owned and occupied. For example, if the book value of a parcel of real estate owned and occupied in whole or in part by the company is $1,000,000, the rents received from other tenants $30,000, taxes and expenses $40,000, and depreciation $20,000, the company would have to include in its gross income a sum not less than $70,000 ($40,000 taxes and expenses, plus $20,000 depreciation, minus $30,000 rents from tenants, plus 4 percent of $1,000,000) as the rental value of the space occupied

by it in order to avail itself of the deductions of $40,000 and $20,000. In any case the rents received from other tenants must be included in gross income."

The petitioner claimed and was allowed deductions under (6) and (7) in respect of the entire building which it owned and in part occupied, and there has been no dispute as to the amounts of the deductions. For 1923, they aggregated $70,005.18 and for 1924, $85,918.97. Nor is it disputed that, within the meaning of subsection (b), the book value of the entire building was, at the end of 1923, $460,000, and of 1924, $49,257.97, of which 4 percent is $18,400 and $19,770.32, respectively. The gross rents received from other tenants were $73,620.48 and $71,289.21, respectively. Neither the rental value nor the book value of the space occupied by petitioner is in evidence, and it can not be inferred, as petitioner suggests, that the amount is one twelfth of the stipulated book value.

The respondent's method of computing the figure to be included in gross income under subsection (b) to support any deduction under (6) and (7) is based upon the assumption that the statute required a minimum net rent of 4 percent of the book value of the entire building. In order to arrive at this figure he includes as rental value of the space occupied by petitioner, $14,784.70 for 1923 and $34,400.08 for 1924. The petitioner insists that such figures are not in accordance with the statute and that the error lies in assuming that the 4 percent minimum provided by the last sentence of section 245 (b) is computed upon the book value of the entire building. The contention is that the statutes "provide that the sum to be returned as rents for the space so occupied, is 4 percent of the book value of such space at the end of the taxable year." The method thus urged by petitioner is to add to rents actually received (less taxes, depreciation, and expenses) an amount equal to 4 percent of the book value of the space occupied by it.[2] Since such book value is not in evidence, petitioner would fail, even if its construction of the statute were correct. But, in our opinion, such construction

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[2] If we were to adopt petitioner's suggestion that book value of space occupied is one twelfth of the stipulated book value of the entire building, petitioner's method would be for 1923 to add to ($73,620.48 less $70,005.18 or $3,615.30) an assumed rental value of (4% of 1-12 of $460,000 or $1,533.33). Thus the rent from the entire building would be taken to be

Rent actually received	$73,620.48
Rental value of space occupied	1,533.33
Gross rent	$75,153.81
Deductions	70,005.18
Net rent taxed	$5,148.63

Instead of which respondent's method arrives at $18,400 or 4% of the book value of the building.

For 1924 petitioner would add to ($71,289.21 less $85,918.17 or minus $14,628.96) an assumed rental of (4% of 1-12 of $494,257.97 or $1,647.52). The rent from the building would thus be—

Rent actually received	$71,289.21
Rental value of space occupied	1,647.52
Gross rent	$72,936.73
Deductions	85,918.17
	$12,981.44

Respondent takes $19,770.32 as net rent.

is without support in either the terms or the theory of the statute. The respondent's method fulfills the clear legislative purpose and is consistent with the context.

The primary purpose of subsection (b) is to correlate gross income from real estate with deductions from real estate. Since deductions are allowed as to the entire building, gross income is likewise computed. To apply depreciation, taxes, and expenses of the entire building against rents received from part would be a distortion. The obvious purpose of augmenting rents actually received by rental value of space occupied was to effect a sym'etry. The 4 per cent minimum was an aid in arriving at a figure to be used as net rent from the entire building. It would assure a net rent great enough to justify the deductions permitted, and reduce controversy as to actual rental value.

32 The construction urged by petitioner is in effect that rental value of the space occupied should be not less than 4 per cent of the book value thereof. Had this been meant, it could have been so simply stated that we can not believe Congress would have used a locution so much more complicated. While the closing words "owned or occupied" are grammatically somewhat obscure, they may fairly be read in consonance with the plain intendment of the statute as above set forth.

It is our opinion, therefore, that respondent has correctly construed the statute and that the deficiencies determined are in accordance therewith.

The petitioner contends that this construction of the statute renders it unconstitutional, and urges that such a result will be avoided by adopting its own construction, as above described. There is, of course, a well recognized doctrine that doubtful statutory construction involving possible unconstitutionality should always be rejected in a favor of a reasonable construction by which the constructional conflict can be avoided. United States vs. Delaware & Hudson Co., 213 U.S. 266; Lucas vs. Alexander, U.S. But we do not understand this to require an interpretation of the statute which seems clearly at variance with the plan and purpose indicated by the plain meaning of the language used. So long as there seems to us to be no ambiguity in the statute, we are constrained to apply it according to its tenor and terms, and not to strain it into a strange meaning in order to avoid an attack of unconstitutionality. That would be to rewrite the law and substitute for the plain legislation adopted by Congress after deliberation a more subtle design not contemplated, or perhaps purposely rejected. The Board's power of interpretation does not include such a function. Furthermore, if the statute is unconstitutional as contended, the petitioner's construction does not save it. The weakness alleged to be inherent is, as will be hereafter seen, equally applicable under either construction. For if the attempted inclusion in income of rental value of space occupied by the owner and its computation at a percentage minimum, as prescribed, are contrary to the Constitution, this must be no

33 less so when petitioner's method is used resulting in a smaller minimum than under respondent's method resulting in a greater. In either case, it is the inclusion of rental value, actual or minimum, upon which the attack centers under the Constitution.

Respondent insists that the statute is not in violation of the Constitution and that the Board should on the merits decide it to be valid. We are therefore confronted squarely with the opposing contentions, and we see no reason why we should refrain from considering them and deciding on this ground whether the deficiency determined by the Commissioner is lawfully due from petitioner.

The petitioner contends that the act purports to impose an income tax upon rental value, that this is not income, that the effect is to impose a direct tax without apportionment, and that this is as much so when the method used is to allow deductions upon condition that gross income shall contain improper inclusions as it would be if the tax were in all instances expressly based on items not income; further, that the minimum required to be returned as income from the building and the method of arriving at it by the mathematical formula contained in the second sentence of section 245 (b) are invalid as having no relation to income.

That the tax was intended to be an income tax is plain. The statute in which it is found contains numerous titles. Title II is called income tax and, except for general administrative provisions, purports to impose the income tax and to contain all the provisions relating thereto. More especially, the insurance sections expressly impose a tax on income, in lieu of the general corporation income tax of section 230, and define the "net income" which is the subject of the tax. Other titles and other sections impose the profits tax and various excise taxes. It seems entirely proper, therefore, to judge this tax by the standards of an income tax under the sixteenth amendment, cf. Flint v. Stone Tracy Co., 220 U.S. 107, and not to lift it into some other category with tests more liberal or strict than those which presumably were intended to be ap-

34 plied. In Pollock v. Farmers Loan & Trust Co., 157 U.S. 429, 158 U.S. 601; Eisner v. Macomber, 252 U.S. 189; and National Life Insurance Co. v. United States, 277 U.S. 508, the Supreme Court made it clear that a tax which, when judged by its own terms, was contrary in effect to the requirements of the Constitution would be condemned. The inclusion of stock dividends in gross income was held in Eisner v. Macomber, supra, to result in direct tax and was condemned for want of apportionment; and the Court did not find it necessary to inquire whether there was any way of saving it by calling it an excise tax subject only to geographical uniformity. And in the National Life Insurance Co. case, supra, the Court rejected the argument contained in the briefs of counsel that the very tax on insurance companies now at bar in truth and excise tax and as such not open to attack. See also Spraeckels v. McClain, 192 U.S. 397.

Respondent suggests, however, that since Congress has not measured the tax by using all petitioner's income, such as premium receipts or sales profits, as it might have done, petitioner could only complain by showing that the tax now determined for assessment is greater in amount than it would have been if Congress had used its power to the full extent. The argument is in effect the same as saying that since Congress might have established a percentage rate of tax of 50 percent instead of the 12½ percent used, no one may complain if by including in gross income except items like stock dividends or tax-exempt interest, he is only taxed at a rate of 40 percent. By defining statutory gross income to include only interest, dividends, and rents, the intention was disclosed to omit all other factors from consideration. National Life Insurance Co. v. United States, supra. The effect otherwise would be to include premium receipts in gross income to the uncertain extent necessary to make up in each case for items improperly included, such as interest from State securities, or capital property like stock dividends, and thus to defeat the manifest legislative purpose to leave premium receipts entirely out of the income taxed. Thus to Congress would be ascribed the recondite purpose of ostensibly releasing
35 premiums from tax while actually requiring them to be used to validate particular taxes which would otherwise invade constitutional rights. We reject this and treat the statute as candidly expressing its design and purpose. "The plain, obvious, and rational meaning of a statute is always to be preferred to any curious, narrow, hidden sense that nothing but the exigency of a hard case and the ingenuity and study of an acute and powerful intellect would discover." Lynch v. Alworth-Stephens Co., 267 U.S. 364. Looking, therefore, at the statute before us in the light in which it was enacted, that of an income tax, and its purpose to tax only income found in interest, dividends, and rents, we examine it to see whether it has mistakenly employed means to bring about an effect prohibited by the Constitution.

In respondent's determination for 1924 it appears that the taxes, expenses, and depreciation amounted to $85,918.97, while the rents actually received were $71,289.21, thus showing a financial loss of $14,629.76. Whether there would be a loss if the income derived from the business conducted by petitioner in the space were reckoned in the computation is unknown, but since the statute expressly leaves such income out of the equation we may not inquire. The loss is required to be overcome by the treatment as gross income of rental value of the space occupied, and a hypothetical rental value computed upon a mathematical formula is to be used as a minimum irrespective of its remoteness from value in fact. The formula prescribed brings about a rental value of space occupied which varies inversely with the actual rents received from the comparable space rented. The entire net rent is in any event to be taken at 4 percent of book value; the rents received and deductions are factually cer-

tain, hence the rental value of space occupied must always be such a figure as happens to be needed to make up the 4 percent minimum. Thus when the net rent received is low, the hypothetical rental value of space occupied is high, and vice versa; although the converse is not true if the taxpayer's actual rental value is greater than
36 the figure used to make up the 4 percent minimum. In the present case the taxpayer occupied about one out of twelve stories. For 1923 it received actual rents of $73,620.48 for eleven stories, the expenses, taxes, and depreciation were $70,005.18, and the one story occupied was consequently valued at $14,784.70 in order to arrive at the minimum 4 percent of the book value of $460,000. For 1924 rents received dropped to $71,289.21, expenses increased to $85,918.97, and the one story was consequently valued at $34,400.08 (more than double the 1923 figure) to maintain the 4 percent of book value of $494,257.97.

The petitioner insists that this illustrates an attempt to tax as income a figure which is not income and which has no reasonable relation to income. This contention affects only the validity of the use of a purely mathematical rental value and of the particular method prescribed in the second sentence of section 245 (b) to arrive at a figure to be used in lieu of the actual rental value. The suggestion also arises that since "book value" has no necessary relation to actual value, Virginia v. West Virginia, 238 U.S. 202, a percentage based thereon to arrive at a minimum rental value has no relation to income. But the more sweeping objection is that by requiring that rental value be included in gross income in order to permit the deductions, a direct tax has been laid without apportionment upon something other than income, and that this is contrary to article I, section 9, of the Constitution and not within the sixteenth amendment.

Notwithstanding the tremendous weight of the presumption of constitutional validity to be attributed to this, as to all other, acts of Congress, and the consequent disposition of the Board to consider with skepticism any argument with which it is attacked, we can find no reasonable escape from the conclusion that the act conflicts with the Constitution and that the deficiency cannot be sustained.

In Pollock v. Farmers Loan & Trust Co., 157 U.S. 429, 158 U.S. 601, it was taken as beyond argument that a tax upon real property by reason of its ownership and based upon its value was a direct tax requiring apportionment, as it has been said to be from the
37 beginning of the Government. Hylton v. United States, 3 Dall. 171; Veazie Bank v. Fenno, 8 Wall. 533; Scholey v. Rew, 23 Wall. 331; Springer v. United States, 102 U.S. 586. It was upon this as an axiom that it was decided in the Pollock case that the tax on income from real estate in the form of rents was so truly a tax on the real estate itself as to be likewise a direct tax, at that time requiring apportionment. In the first opinion in the Pollock case, the Court said:

"* * * The real question is, is there any basis upon which to rest the contention that real estate belongs to one of the two great classes of taxes, and the rent or income which is the indictment of its ownership belongs to the other? We are unable to perceive any ground for the alleged distinction. An annual tax upon the annual value or annual user of real estate appears to us the same in substance as an annual tax on the real estate, which would be paid out of the rent or income. This law taxes the income received from land and the growth or produce of the land. Mr. Justice Paterson observed in Hylton's case, 'land, independently of its produce, is of no value', and certainly had no thought that direct taxes were confined to unproductive land."

In the second opinion appears the following:

"The Constitution prohibits any direct tax, unless in proportion to numbers as ascertained by the census, and, in the light of the circumstances to which we have referred, is it not an evasion of that prohibition to hold that a general unapportioned tax, imposed upon all property owners as a body for or in respect of their property, is not direct, in the meaning of the Constitution, because confined to the income therefrom?

"Whatever the speculative views of political economists or revenue reformers may be, can it be properly held that the Constitution, taken in its plain and obvious sense, and with due regard to the circumstances attending the formation of the Government, authorizes
a general unapportioned tax on the products of the farm and
38 the rents of real estate, although imposed merely because of
ownership, and with no possible means of escape from payment, as belonging to a totally different class from that which includes the property from whence the income proceeds?

"There can be but one answer, unless the consti'utional restriction is to be treated as utterly illusory and futile, and the object of its framers defeated. We find it impossible to hold that a fundamental requisition deemed so important as to be enforced by two provisions, one affirmative and one negative, can be refined away by forced distinctions between that which gives value to property and the property itself."

What ever may be said about the nature under the Constitution of a tax upon income derived from sources other than real estate, an inquiry not required by the present case, there is little ground for doubt that a tax on real estate is a direct tax, and that a tax on the income therefrom was held to be equally so. Cf. Brushaber v. Union Pacific Railroad Co., 240 U.S. 1. Before the sixteenth amendment, both were said in the Pollock case to have required apportionment; and the effect of the amendment was that the tax on income alone was freed from such apportionment, the tax on the real estate being still left subject to article I, section 9. Peck v. Lowe, 247 U.S. 165; Eisner v. Macomber, 252 U.S. 189; Evans v. Gore, 253 U.S. 245. The amendment "confers no power upon Congress to define and

tax as income without apportionment something which theretofore could not have been properly regarded as income", Taft v. Bowers, 278 U.S. 470.

Thus the only theory upon which a tax on the rental value of real estate occupied by the owner could be laid without apportionment would be that such rental value is income within the legal signification of that term as used in the sixteenth amendment. That it may be sometime regarded as income by economists some of whom may use the term as applying to benefits or enjoyments is not controlling, Lynch v. Turrish, 247 U.S. 221; Merchants Loan & Trust Co. v. Smietanka, 255 U.S. 509. Nor may we look to the use and
39 meaning of the word income found in statutes of several of the States, for the same constitutional requirements do not exist to give force to the limitations of definition. Here the restriction upon Congress is that it may not use or define the term so as to bring about an unapportioned direct tax, and no authority can be attached to a usage free from a similar restriction. The English usage to exclude profits from capital sales were disregarded in Merchants Loan & Trust Co. v. Smietanka, supra; and the Massachusetts usage to include stock dividends was disregarded in Eisner v. Macomber, supra. In the 1894 act, which was the precursor of the sixteenth amendment, rents were included, but no reference was made to rental value, and, as we have seen, the Pollock case took as a postulate that the use and value of realty was the realty itself rather than the income therefrom. The Corporation Excise Tax Act of 1909 used income in the same sense as a measure of excise tax, Flint v. Stone Tracy Co., 220 U.S. 107. Therefore there is nothing in the history immediately preceding the sixteenth amendment to give support to a more expansive use of the word income than that considered in the Pollock case. And clearly nothing can be said for treating rents—which indubitably are income—as including rental value of space owned and occupied. Rent has since feudal times implied two separate persons and estates, those of landlord and tenant, and it would be a misnomer to apply it to the value of a landlord's use and occupancy of his own property. Thompson on Real Property; Tiffany on Real Property; 36 Corpus Juris 285. See also Duffy v. Central R.R., 268 U.S. 55.

It seems to us furthermore that a construction of income to include rental value of occupancy of realty by its owner would be to narrow the force of the requirement of apportionment to a point of practical nullification.

"A proper regard for its genesis, as well as its very clear language, requires also that this amendment shall not be extended by
40 loose construction, so as to repeal or modify except as applied to income, those provisions of the Constitution that require an apportionment according to population for direct taxes upon property, real and personal. This limitation still has an appropriate and important function and is not to be overridden by Con-

gress or disregarded by the courts." Eisner v. Macomber, 252 U.S. 189, 206.

Since, as we have seen, to tax the use or value of realty as distinguished from rents or profits is to tax the realty itself, it would result that although the requirement of apportionment would nominally remain applicable to a tax imposed eo nomine upon the realty itself, still a tax in the same measure upon rental value of realty occupied by the owner would escape apportionment. The speciousness of such a differentiation is obvious.

"If it be true that by varying the form the substance may be changed, it is not easy to see that anything would remain of the limitations of the Constitution or of the rule of taxation and representation so carefully recognized and guarded in favor of the citizens of each State. But constitutional provisions cannot be thus evaded." * * * Pollock v. Farmers Loan & Trust Co., 157 U.S. 429, 581.

The use and meaning of the word income at the time of its incorporation in the sixteenth amendment has been considered by the Supreme Court in several cases since the amendment with an effect consistent, we think, with our understanding and with sufficient applicability to the present problem to be binding upon us.

In Stratton's Independence v. Howbert, 231 U.S. 399, decided December 1, 1913, the question arose under the Corporation Tax Act of 1909 whether income, which measured the tax, included the proceeds of mining operations, and the court said:

> Income may be defined as the gain derived from capital, from labor, or from both combined.

41 See Doyle v. Mitchell Bros. Co., 247 U.S. 179. This definition has been applied to the amendment and to the later income-tax acts under it. In Eisner v. Macomber, supra, the Court expounded the definition so as to make it clear that the gain must be more than a mere increment or appreciation of value within the capital property. It must be "something of exchangeable value proceeding from the property, severed from the capital, however invested or employed, and coming in, being derived—that is received or drawn by the recipient (the taxpayer) for his separate use, benefit, or disposal—that is income derived from property." This was said in order to demonstrate that a stock dividend was not income, although by the receipt of new certificates a stockholder might deal separately to some extent with his increment. As to stock rights, the Court held similarly in Miles v. Safe Deposit & Trust Co., 259 U.S. 247, and said:

"The right to subscribe to the new stock was but a right to participate, in preference to strangers and on equal terms with other existing stockholders, in the privilege of contributing new capital called for by a corporation—an equity that inheres in stock ownership under such circumstances as a quality inseparable from the capital interest represented by the old stock, recognized so uni-

versally as to become axiomatic in American corporation law. * * *"

In Goodrich v. Edwards, 255 U.S. 527, the taxable gain derived from a sale of capital assets (Merchants Loan & Trust Co. v. Smietanka, 255 U.S. 509) was confined to the excess over original investment despite a lower value of March 1, 1913. This was because the Constitution required it. Lucas v. Alexander, U.S. A subsidy was held to be capital contribution by the State and not a gain, Edwards v. Cuba R.R. Co., 268 U.S. 628, and a mathematical gain was excluded from the definition where it was incidental to an actual loss, Bowers v. Kerbaugh-Empire Co., 271 U.S. 170. The importance of separation was manifested in Taft v. Bowers, 278 U.S.
42 470, holding the donee of stock who sells for a price in excess of his donor's cost taxable upon the gain. The Court said:

"In truth the stock represented only a single investment of capital—that made by the donor. And when through sale or conversion the increase was separated therefrom, it became income from that investment in the hands of the recipient subject to taxation according to the very words of the sixteenth amendment. * * *"

While these several decisions deal with problems specifically different from the one at bar, they indicate a tacit recognition that income is more than mere use or enjoyment of one's own property in its original form. There must be some sort of consumated pecuniary gain from which the tax can be paid. We find no intimation that rental value of property occupied may be regarded as income any more now than at the time of the decision in the Pollock case. This being inherent in the Constitution itself, Congress is precluded from broadening the meaning by legislation.

"In order therefore that the clauses cited from article I of the Constitution may have proper force and effect, save only as modified by the amendment, and that the latter also may have proper effect, it becomes essential to distinguish between what is and what is not 'income', as the term is there used, and to apply the distinction, as cases arise, according to truth and substance, without regard to form. Congress cannot by any definition it may adopt conclude the matter, since it cannot by legislation alter the Constitution from which alone it derives its power to legislate, and within whose limitations alone that power can be lawfully exercised." Eisner v. Macomber, 252 U.S. 189.

"It is true that Congress cannot make a thing income which is not so in fact." Burk-Waggoner Oil Association v. Hopkins, 269 U.S. 110.

See also Taft v. Bowers, supra.

43 The next question, assuming it to be established that rental value of space occupied by the owner may not be included in his income directly, is whether there is nevertheless the power to say that no deduction shall be allowed of taxes, expenses, and depreciation unless such rental value is included in gross income. A tax

upon such rental as income without apportionment being prohibited, the inquiry is similar to that discussed in Evans v. Gore, 253 U.S. 245; Miles v. Graham, 268 U.S. 501; and National Life Insurance Co. v. United States, 277 U.S. 508. A Federal judge's salary, being protected from diminution, may not be required to be included in gross income, Evans v. Gore, supra.

If the tax in respect of his compensation be prohibited, it can find no justification in the taxation of other income as to which there is no prohibition; for, of course, doing what the Constitution permits gives no license to do what it prohibits.

* * * * * * * * *

* * * The taxing act directs that the compensation—the full sum, with no deductions for expenses—be included in computing the net income, on which the tax is laid. If the compensation be the only income, the tax falls on it alone; and, if there be other income, the inclusion of the compensation augments the tax accordingly. In either event the compensation suffers a diminution to the extent that it is taxed.

In Miles v. Graham, supra, applying the rule of Evans v. Gore to judges of the Court of Claims, the Supreme Court said:

"No judge is required to pay a definite percentage of his salary, but all are commanded to return, as a part of 'gross income' the compensation received as such from the United States. From the gross income various deductions and credits are allowed, as for interest paid, contributions or gifts made, personal exemptions varying with family relations, etc., and upon the net result assessment is made. The plain purpose was to require all judges to return
44 their compensation as an item of 'gross income' and to tax this as other salaries. This is forbidden by the Constitution."

The recent decision in National Life Insurance Co. v. United States, supra, is still more pertinent in its analogy. There, as here, the Constitution protected a subject from tax under the sixteenth amendment—there, interest from certain securities; here rental value of space occupied. In both cases a deduction was limited by reason of the protected subject, the deduction there being that of 4 percent of the reserves, and here of taxes, expenses, and depreciation. The argument for the validity of the statute was made there, as here, that as the deduction was not essential, its limitation was discretionary. Without deciding whether a deduction for taxes, expenses, and depreciation in respect of real estate is essential to the computation of net income where the rents received are included in the gross (cf. Von Baumbach v. Sargent Land Co., 242 U.S. 503; Doyle v. Mitchell Bros. Co., 247 U.S. 179; United States v. Anderson, 269 U.S. 422; United States v. Ludey, 274 U.S. 295), it can safely be said that it is no less so than that of a percentage of reserves to life insurance companies, and for present purposes the situation is therefore similar. We quote from the opinion:

"The portion of petitioner's income from the three specified sources which Congress had power to tax—its taxable income—was the sum of these items less the interest derived from tax-exempt securities. Because of the receipt of interest from such securities, and to its full extent, pursuing the plan of the statute the collector diminished the 4 percent deduction allowable to those holding no such securities. Thus, he required petitioner to pay more upon its taxable income than could have been demanded had this been derived solely from taxable securities. If permitted this would destroy the guaranteed exemption. One may not be subjected to greater burdens upon his taxable property because he owns some that
45 is free. No device or form of words can deprive him of the exemption for which he has lawfully contracted.

The suggestion that, as Congress may or may not grant deductions from gross income at pleasure, it can deny to one and give to another, is specious but unsound. The burden from which Federal and State obligations are free is the one laid upon other property. To determine what this burden is requires consideration of the mode of assessment, including, of course, deductions from gross values. What remains after subtracting all allowances is the thing really taxed."

* * * * * * *

Congress had no power purposely and directly to tax State obligations by refusing to their owners deductions allowed to others.

We are thus compelled by authority to reach the conclusion that the inclusion in gross income of rental value of space occupied by the taxpayer in its own building for tax without apportionment, as a condition of the deduction of any taxes, depreciation, or expenses, is forbidden. It should not be overlooked that the condition of paragraph (b) is not applicable alone to such amount of the deductions under (6) and (7), as compares with space occupied, but operates as a condition of such deductions in any amount in respect of the whole building. Unless the taxpayer returns as gross income the rental value of the one story occupied, it may not have any deductions whatever of the charges applicable to any part of the building, notwithstanding all rents received are returnable. The alternative given is to pay tax on gross rents received without deduction or to pay tax on net rents received plus rental value of space occupied. This, we think, is subject to at least the objection stated by the Supreme Court in the National Life Insurance Co. case, and is consequently an invalid provision.

It is important, however, that the other objections to paragraph (b) should be considered since it is quite conceivable that the foregoing may in some respect be found wanting, and the importance of an issue under the Constitution justifies a broad inquiry and requires the fullest consideration. Assuming, therefore, that
46 the first sentence of the paragraph is beyond attack, so that

true rental value of space occupied is properly required to be included in gross income, the next inquiry is as to the validity of the second sentence. By this, as has been seen, it is provided that no figure will be recognized as rental value of space occupied which is less than enough to bring about, with net rents received, a net income from the building of 4 percent of its book value. The mathematical operation of this provision in the case at bar has been already set forth. For 1923 it brought about a figure of $14,784.70 as the rental value of one story, to be added to $73,620.48 from tenants for eleven stories; for 1924, rental value of the same one story was computed at $34,400.08, as compared with $71,289.21 received for the remainder. Although the rents received were diminished from 1923 to 1924, and the charges increased from $70,905.18 to $85,918.87, giving an apparent indication of reduced rental value of space in the building, the required formula forces an increased rental value of the story occupied to more than double. Whether this is typical of the application of the statute or unique does not appear. It is the actual situation as to this taxpayer brought about by the plain requirement of the statute, and to him it cannot be said that it is an extreme illustration. As to 1924, it results in a tax based upon artificial income whereas in fact there has been a loss. Being unable to derive 4 percent net income from the building, petitioner is nevertheless required to construct its tax return so that it will be taxed as if it did.

It seems clear that such a tax is not upon income, but its effect is to tax the realty itself, and what we have said as to the use of actual rental value in gross income is more forcibly true as to such a forced minimum. A 4 percent income from an insurance building may approximate an actual or average return (and we should perhaps assume that Congress so regarded it), but it is not true income within the sixteenth amendment unless it has in fact been derived from the property or capital invested. To base the tax upon the assumption that it was in fact realized, irrespective of whether it was or not,

is not the power granted by the sixteenth amendment; and
47 since this is the only authority under which Congress *ed* assumed to act in title II, it must fail of its purpose and be held invalid.

What we have said as to the use of the artificial 4 percent minimum is likewise true of the use of book value as its basis. How book value in any given case may be arrived at or what it means is not set forth in the statute, and whether it has a meaning as to life insurance companies sanctioned by law does not appear. Regulations 62, issued under the Revenue Act of 1921, treat the accounts of life insurance companies as uniform. But bookkeeping entries are not conclusive, Doyle v. Mitchell Bros. Co., supra, and the book value of property is not to be taken as actual value, Virginia v. West Virginia, 238 U.S. 202. Thus to take book value as the standard upon which the percentage return is to be measured is to depart from fact, and just so far to define income beyond its true bounds. And

we say this, even assuming that the particular book value represents actual cost with proper adjustments for wear and tear, etc., for if the investment has proved ill-advised the actual value may be far below cost and a 4 percent return on book value may be impossible to derive.

"It is urged that the book value represents actual value where books are correctly kept. This is not necessarily true, as books may be said to be correctly kept, in a sense, when they truly state the items set forth. But cost carried forward may not be the same as present value. Despite repairs and renewals, a suitable allowance for depreciation may not have been made. It would be too much to say that there is any controlling presumption * * *.

* * * * * * * *

"On the other hand, in the absence of a more complete showing with respect to the physical property and its condition, the expenditures for maintenance and the extent of depreciation, it is wholly impossible to say that the book cost represented the actual value at the time to which the inquiry was addressed. Book cost, as we have said, would be a more or less doubtful criterion." Virginia v. West Virginia, 238 U.S. 202.

Thus we are driven to the conclusion, despite the presumption to the contrary, that paragraph (b), although correctly construed and applied by respondent, invades this petitioner's constitutional rights.

48. Our decision, therefore, is that the deficiency is invalid insofar as it results from the inclusion in gross income of any figure representing rental value of the space occupied by petitioner in its building.

Reviewed by the Board.

Judgment will be entered under Rule 50.

Dissenting opinion

MARQUETTE, dissenting: The opinion herein holds that "the respondent has correctly construed the statute and that the deficiencies determined are in accordance therewith." When the Board reaches such a conclusion I believe it has exhausted its powers, except to enter a judgment for the respondent. The opinion proceeds, however, to discuss the constitutionality of the statute and reaches the conclusion that it is unconstitutional. This, in my opinion, is a clear usurpation of a judicial function not possessed by this Board. I have had occasion heretofore, in Henry Cappellini, 14 B.T.A. 1269, to express the idea that the power to declare an act of Congress unconstitutional is exclusively a judicial function; that no part of the judicial power of the United States, in a constitutional sense, is vested in this Board, and that the Board is without power to approach such a question. I am still of the same opinion. However persuasive the reasoning may be, or however logical the conclusion, it offers no excuse for the exercises of a power which we do

not possess. It seems to me that such a pronouncement is binding on no one, and I believe the respondent is entitled to collect the deficiency as determined by him.

MORRIS and VAN FOSSAN agree with the above dissent.

Now, Dec. 13, 1930, the foregoing findings of fact and opinion certified from the record as a true copy.

[SEAL] B. D. GAMBLE,
Clerk, U.S. Board of Tax Appeals.

49 Before U.S. Board of Tax Appeals

Judgment

Entered November 18, 1929

Following the Board's report promulgated October 4, 1929 (17 B.T.A. 757), the respondent, under Rule 50, submitted a proposed judgment which petitioner agrees is in conformity with the said report. In accordance therewith it is

Ordered, adjudged, and decided that there is an overpayment of income tax for 1923 of $112.86 and for 1924 of $226.79.

Now, Dec. 13, 1930, the foregoing decision certified from the record as a true copy.

[SEAL] B. D. GAMBLE,
Clerk, U.S. Board of Tax Appeals.

Before U.S. Board of Tax Appeals

Petition for review in the United States Circuit Court of Appeals and assignments of error

Filed May 13, 1930

Now comes Robert H. Lucas, Commissioner of Internal Revenue, by his attorneys, G. A. Youngquist, Assistant Attorney General, and C. M. Charest, general counsel, Bureau of Internal Revenue, and respectfully shows:

I

That he is the duly appointed, qualified, and acting Commissioner of Internal Revenue, appointed and holding his office by virtue of the laws of the United States; that the Independent Life Insurance Company of America is a corporation subject to the provisions of the Federal income tax laws, whose principal office is located in the city of Nashville, Tennessee, and whose returns for Federal income
50 tax purposes for the taxable years 1923 and 1924 were made to the collector of internal revenue for the district of Tennessee, whose office is located in Nashville, Tennessee, which is within the jurisdiction of the United States Circuit Court of Appeals for the Sixth Circuit.

II

That the nature of the controversy is a follows, to wit:

The taxpayer is a life insurance company which, during the years 1923 and 1924, was regularly engaged in the conduct of its business in the city of Nashville, Tennessee. It owned a twelve-story building located in said city, part of which it occupied as its own office, and part of which it rented to tenants.

In computing it net income for the taxable years 1923 and 1924, the taxpayer claimed deductions under the provisions of section 245 (a), 6 and 7 of the Revenue Acts of 1921 and 1924, said deductions being for taxes, expenses, and depreciation in respect to the entire building which it owned and in part occupied; but it did not include in gross income the rental value of said building as provided in section 245 (b) of said acts. The respondent allowed said deductions, but he included in the taxpayer's gross income the rental value of said office space. This resulted in tax deficiencies being determined for the taxable years 1923 and 1924 in the respective amounts of $298.97 and $1,115.65.

III

The taxpayer appealed from said determinations of the Commissioner to the United States Board of Tax Appeals. The Board held that the Commissioner had correctly construed the provisions of section 245 (b) of the Revenue Acts of 1921 and 1924, and had correctly determined the deficiencies in accordance therewith; but it held that said provisions of the statute were in conflict with the Constitution, and hence were invalid. It held that there were no deficiencies in tax for the years 1923 and 1924, but that there were overpayments for said years in the respective amounts of $112.86 and $226.79.

The hearing was held before the Board on January 29, 1929,
51 and the interlocutory decision of the Board, its findings of fact and opinion were promulgated October 4, 1929. The Board's final order of redetermination, adjudging that there were overpayments of tax for the years 1923 and 1924, was entered November 18, 1929.

IV

That the Commissioner, being aggrieved by the said decision of the Board of Tax Appeals and also by the said order of redetermination, desires to obtain a review of said decision and order by the United States Circuit Court of Appeals for the Sixth Circuit; and as reasons for such review, he alleges that the Board, in rendering its opinion and entering its final order of redetermination, committed the following errors:

1. The Board of Tax Appeals erred in determining that there were no deficiencies in the amounts of the taxpayer's income tax for the taxable years 1923 and 1924.

2. The Board erred in failing to approve the determinations made by the Commissioner that there were deficiencies in tax for the taxable years 1923 and 1924 in the respective amounts of $298.97 and $1,115.65.

3. The Board erred in determining that there were overpayments of tax made by the Commissioner for the taxable years 1923 and 1924.

4. The Board erred in holding that the rental value of office space owned and occupied by a life insurance company is not income under the sixteenth amendment to the Constitution, and may not properly be included in its gross income for income tax purposes.

5. The Board erred in concluding that a life insurance company may not properly be required to include in its gross income the rental value of real estate owned and occupied by it as a condition to the deduction to taxes, depreciation and expenses relative to said real estate.

6. The Board erred in concluding that the provisions of section 245 (b) of the Revenue Acts of 1921 and 1924 are in conflict with the Constitution.

7. The Board erred in disapproving deficiencies determined by the Commissioner which it found were properly computed in accordance with the provisions of the statute.

52 8. The Board erred in concluding that it had power to declare an act of Congress unconstitutional, and in refusing to follow the provisions of said act.

9. The Board erred in disregarding the published regulations of the Treasury Department relative to the Revenue Acts of 1921 and 1924, and also in disregarding the established practice of the Internal Revenue Bureau in admonishing said acts.

10. The Board erred in rendering an opinion and entering an order of redetermination which are contrary to the law.

Wherefore, the Commissioner petitions that said decision and order of the Board of Tax Appeals be reviewed by the United States Circuit Court of Appeals for the Sixth Circuit; that a transcript of the record be prepared in accordance with the law and the rules of said Court, and be transmitted to the Clerk of said Court for filing; and that appropriate action be taken to the end that the errors herein complained of may be reviewed and corrected by said Court.

(Signed) G. A. YOUNGQUIST,
Assistant Attorney General.
(Signed) C. M. CHAREST,
General Counsel, Bureau of Internal Revenue.

Of Counsel.
ALLIN H. PIERCE,
Special Attorney,
Bureau of Internal Revenue.

[*Duly sworn to by C. M. Charest, jurat omitted in printing.*]

53 Sworn and subscribed to before me this 12th day of May, 1930.

(Signed) MARCELLETTE M. TAYLOR,
Notary Public.

(My commission expires March 31, 1935.)

Before U.S. Board of Tax Appeals

Notice of petition for review

Filed May 17, 1930

To: Independent Life Insurance Company of America, Independent Life Building, 4th and Church Streets, Nashville, Tennessee.

To: James A. Newman, Esq., Independent Life Building, Nashville, Tennessee.

You, and each of you, are hereby notified that this office has today filed with the United States Board of Tax Appeals on behalf of the Commissioner of Internal Revenue, a petition seeking a review of the Board's decision in the above-entitled cause by the United States Circuit Court of Appeals for the Sixth Circuit, a copy of which petition is hereto attached and served upon you.

Dated at Washington, D.C., this 13th day of May, 1930.

(Signed) C. M. CHAREST,
General Counsel, Bureau of Internal Revenue.

54 Receipt of the above and foregoing notice, together with a copy of the petition for review mentioned therein, is hereby acknowledged this 15th day of May, 1930.

(Signed) INDEPENDENT LIFE INS. CO.,
By PAUL ROBERTS, *Pres.*,
Taxpayer.

(Signed) JAMES A. NEWMAN,
Attorney for taxpayer.

Now, Dec. 13, 1930, the foregoing petition for review and notice of filing certified from the record as a true copy.

[SEAL] B. D. GAMBLE,
Clerk, U.S. Board of Tax Appeals.

Before U.S. Board of Tax Appeals

Statement of evidence

Filed November 20, 1930

The sole evidence in this cause consists of a stipulation of facts, which was entered into by the attorneys for both parties, as follows:

Stipulation of facts

It is hereby stipulated and agreed by and between the parties to the above-entitled appeal, by their respective counsel:

(1) That the petitioner, Independent Life Insurance Company of America, is a life insurance company, with its home office located at Nashville, Tennessee.

(2) That on January 25, 1927, the respondent mailed to the petitioner a notice of deficiency showing proposed deficiencies for the calendar years 1923 and 1924 in the amounts of $298.97 and $1,115.65, respectively. A copy of said notice of deficiency is attached hereto as exhibit A, it being agreed that the book value of
55 petitioner's building for the years 1923 and 1924 and the amounts shown therein as rents received from other tenants covering space occupied by others than the company are correct and the facts in this case.

(3) That during the years 1923 and 1924 the petitioner owned a twelve-story building located in the city of Nashville, Tennessee. The petitioner in 1923 and 1924 occupied about one story of said building as its home office and rented such portions of the remainder of the building as it was able to secure tenants for.

(Signed) JAS. A. NEWMAN,
Counselor for Petitioner.

(Signed) C. M. CHAREST,
General Counsel, Bureau of Internal Revenue.

Exhibit "1" to stipulation of facts

INDEPENDENT LIFE INSURANCE COMPANY. JAN. 25, 1927.
Independent Life Building,
Corner Fourth and Church Streets,
Nashville, Tennessee.

SIRS: The determination of your income-tax liability for the years 1923 and 1924, as set forth in office letter dated October 30, 1926, has been changed as the result of your letter dated November 26, 1926, to disclose a deficiency in tax amounting to $1,414.62, as shown in the attached statement.

STATEMENT

IT:CA:2553-9-60D

In re: Independent Life Insurance Company, Independent Life Building, Corner Fourth and Church Streets, Nashville, Tennessee

Year:	Deficiency in tax
1923	$298.97
1924	1,115.65
Total	$1,414.62

56

1923	
Income:	
Interest from all sources	$19,794.81
Rents	88,405.18
Gross income	$108,199.99

1923—Continued

Deductions:		
Interest exempt	$1,948.32	
Excess of 4% of mean of reserve over exempt interest	20,363.33	
Investment expenses	1,946.00	
Taxes	11,147.72	
Other real-estate expenses	51,357.46	
Depreciation	7,500.00	
Interest	8,552.48	
Total deductions		$102,815.31
Adjusted net income		$5,294.68

In connection with the above adjustment of gross income with respect to rents, your attention is invited to article 686, Regulations 62, which reads in part as follows:

"No deduction shall be made for any taxes, expenses, or depreciation on account of any real estate owned or occupied in whole or in part by a life insurance company unless there is included in the return of gross income the rental value of the space so occupied, such rental value shall not be less than a sum which in addition to any rents received from other tenants shall provide a net income (after deducting taxes, depreciation and other expenses) at the rate of 4 percent per annum of the book value at the end of taxable year on the real estate so owned and occupied."

Book value of home office			$460,000.00
Rents received from other tenants		$73,620.48	
Less:			
Expenses	$51,357.46		
Taxes (on R.E.)	11,147.72		
Depreciation	7,500.00		
		70,005.18	
		$3,615.30	
Less: 4% of $46,000.00		18,400.00	
57 Value of space owned and occupied by company to be included in gross income			14,784.70
Rents from other tenants in building in which company occupied space			73,620.48
Total rents to be reported in gross income			88,405.18

You are advised that the amount, $11,376.81, representing permanent improvements has been eliminated from expenses in accordance with section 245 (a) (6) of the Revenue Act of 1921.

COMPUTATION OF TAX

Net income	$5,294.68	
Less: Exemption	2,000.00	
Taxable at 12½%	3,294.68	
Tax at 12½%		$411.83
Previously assessed		212.86
Deficiency in tax		298.97

1924

Income:		
Interest from all sources		$20,519.85
Rents		105,689.29
Gross income BS:3		126,209.14
Deductions:		
Interest exempt	$1,687.81	
Excess of 4% of mean of reserve over exempt interest	22,773.76	
Investment expenses	2,220.34	
Taxes	11,147.00	
Other real estate expenses	67,271.97	
Depreciation	7,500.00	
Interest	868.69	
Total deductions		113,469.57
Adjusted net income		12,739.57

The adjustment for rents is made for the same reason as given in 1928. The computation is as follows:

Book value of home office			$494,257.97
Rents received from other tenants		$71,289.21	
58 Less:			
Expenses	$67,271.97		
Taxes (on R. E.)	11,147.00		
Depreciation	7,500.00		
		85,918.97	
		14,629.76	
Add: 4% of $494,237.97		19,770.32	
Value of space owned and occupied by company to be included in gross income			34,409.08
Rents from other tenants in building in which company occupied space			71,289.21
Total rents to be included in gross income			105,689.29

COMPUTATION OF TAX

Net income	$12,739.57
Less: Exemption	2,000.00
Taxable at 12½%	10,739.57
Tax at 12½%	1,342.44
Previously assessed	226.79
Deficiency in tax	1,115.65

Your return for the year 1922 has been closed, showing no tax liability.

You are advised that the contentions contained in your letter dated November 26, 1926, have been allowed with the exception of permanent improvements included in expenses for 1928.

Payment of the tax should not be made until a bill is received from the collector of internal revenue for your district, and remittance should then be made to him.

The petitioner on review submits the foregoing as a true and correct statement of all of the evidence which was submitted to the

United States Board of Tax Appeals, and prays that the same may be approved and filed as a part of the record in this cause.

(Signed) C. M. CHAREST,
General Counsel, Bureau of Internal Revenue,
Attorney for Petitioner on Review.

59 Approved:

(Signed) JAMES A. NEWMAN,
Attorney for Respondent on Review.

Order approving statement of evidence

The foregoing statement of evidence is a true and complete statement of all of the evidence adduced before the United States Board of Tax Appeals in the above-entitled cause. Said statement is hereby approved, signed, and ordered to be made a part of the record in said cause this 20th day of November 1930.

(Signed) J. M. STERNHAGEN,
Member, United States Board of Tax Appeals.

Now, Dec. 13, 1930, the foregoing statement of evidence certified from the record as a true copy.

[SEAL] B. D. GAMBLE,
Clerk, U.S. Board of Tax Appeals.

Before U.S. Board of Tax Appeals

Praecipe for transcript of record

Filed Nov. 19, 1930

To the Clerk of the United States Board of Tax Appeals:

You are hereby requested to prepare a transcript of the record in this cause, in due time, transmit the same to the clerk of the United States Circuit Court of Appeals for the Sixth Circuit. You are requested to include in said transcript, duly certified as correct, the following documents:

1. Docket entries of the proceedings before the Board.
2. Pleadings before the Board, including amended petition for redetermination and answer to said amended petition.
3. Motion to amend petition, copy of amendment tendered, and order allowing the amendment.

60 4. Findings of fact, opinion, and decision of the Board.

5. Petition for review, and proof of service thereof.
6. Statement of evidence as settled or agreed upon.
7. This praecipe.

(Signed) C. M. CHAREST,
General Counsel, Bureau of Internal Revenue,
Attorney for Petitioner on Review.

Service of the foregoing praecipe and receipt of a copy of the same is acknowledged this 15th day of November 1930. No objection will be filed with respect to the same.

JAMES A. NEWMAN,
Attorney for Respondent on Review.

Now, Dec. 13, 1930, the foregoing praecipe certified from the record as a true copy.

[SEAL] B. D. GAMBLE,
Clerk, U.S. Board of Tax Appeals.

Before U.S. Board of Tax Appeals

Order enlarging time

Upon motion of counsel for petitioner, it is

Ordered: That the time for preparation of the evidence and for transmission and delivery of the record *sur* petition for review of the above-entitled proceeding in the United States Circuit Court of Appeals for the Sixth Circuit be, and hereby is, extended to October 1, 1930.

(Signed) LOGAN MORRIS,
Member.

Dated, Washington, D.C., July 14, 1930.

A true copy:

Teste:

[SEAL] B. D. GAMBLE,
Clerk, U.S. Board of Tax Appeals.

61 Before U.S. Board of Tax Appeals

Order enlarging time

Upon motion of counsel for petitioner, it is

Ordered: That the time for preparation of the evidence and for transmission and delivery of the record sur petition for review of the above entitled proceding in the United States, Circuit Court of Appeals for the Sixth Circuit be, and it is hereby, extended to November 15, 1930.

(Signed) PERCY W. PHILLIPS,
Member.

Dated, Washington, D.C., October 1, 1930.

A true copy:

Teste:

[SEAL] B. D. GAMBLE,
Clerk, U.S. Board of Tax Appeals.

Before U.S. Board of Tax Appeals

Order enlarging time

Upon motion of counsel for petitioner, it is

Ordered: That the time for preparation of the evidence and for transmission and delivery of the record sur petition for review of the above-entitled proceeding in the United States Circuit Court of Appeals for the Sixth Circuit be, and it is hereby, extended to Dec. 15, 1930.

(Signed) LOGAN MORRIS,
Member.

Dated, Washington, D.C., November 15, 1930.

A true copy:

Teste:

[SEAL] B. D. GAMBLE,
Clerk, U.S. Board of Tax Appeals.

62 *Order enlarging time*

For cause appearing of record, it is

Ordered: That the time for transmission and delivery of the record sur petition for review of the above entitled proceedings in the United States Circuit Court of Appeals for the Sixth Circuit be, and it is hereby, extended to January 31, 1931.

(Signed) LOGAN MORRIS,
Member.

Dated, Washington, D.C., Dec. 15, 1930.

A true copy:

Teste:

[SEAL] B. D. GAMBLE,
Clerk, U.S. Board of Tax Appeals.

63 In United States Circuit Court of Appeals for the Sixth Circuit

Cause argued and submitted

Jan. 12, 1932

Before HICKS, HICKENLOOPER, and TUTTLE, J.

This cause is argued by Helen R. Carloss for petitioner and by James A. Newman for respondent and is submitted to the Court.

64 (File indorsement omitted.)

In United States Circuit Court of Appeals, Sixth Circuit

No. 5850

COMMISSIONER OF INTERNAL REVENUE, PETITIONER

vs.

THE INDEPENDENT LIFE INSURANCE COMPANY, RESPONDENT

Petition to review an order of United States Board of Tax Appeals

Certificate of questions filed

December 14, 1932

Before HICKS and HICKENLOOPER, circuit judges, and TUTTLE, district judge.

PER CURIAM: This cause involves the construction and proper scope of sections 243, 244, and 245 of the Revenue Act of 1921, c. 136, 42 Stat. 227, and the Revenue Act of 1924, c. 234, 43 Stat. 253, and the validity of section 245 (b) of said acts.

The respondent is a life-insurance company. During the years 1923 and 1924 it owned a twelve-story building, occupying one story and renting portions of the remainder. In making its income-tax returns for the years 1923 and 1924 it deducted from its gross income from this building taxes, expenses, and an allowance for depreciation, as provided in section 245 (a) (6) and (7) of the applicable acts, but it did not include in its gross income the rental value of the space occupied by it as required by section 245 (b) of each act, such value to be an amount which, added to the rents received from other tenants, would provide a net income, after proper deductions, equal to 4% of the book value of the building.

The Commissioner determined a deficiency for the year 1923 in the sum of $298.97, and for the year 1924 in the sum of
65 $1,115.65, upon the hypothesis that if taxes and other expenses paid during the taxable year exclusively upon or with respect to real estate owned by the company and occupied in whole or in part by it, and a reasonable allowance for depreciation, be deducted under section 245 (a) (6) and (7), the company must include in its return of gross income the rental value of space which it occupied, at the rates specified in section 245 (b). The respondent appealed to the Board of Tax Appeals, and the Board found that the deficiencies for the two years were calculated in accordance with section 245 (b) of the respective acts, but that these sections violated the Constitution of the United States (art. I, sec. 2, cl. 3, and art. I, sec. 9, cl. 4) upon the theory that a tax upon such purely hypothetical rental value was not an income tax, but a direct tax upon real estate without apportionment. The Commissioner thereupon brought the present petition to review.

Upon the foregoing facts, we certify to the Supreme Court of the United States the following questions of law, concerning which we desire instructions for the proper decision of this cause:

(1) Are the provisions of section 245 (b) of the Internal Revenue Acts of 1921 and 1924 valid and constitutional enactments, and enforceable in respect of the minimum rental values therein prescribed?

(2) If the first question be answered in the negative, was the respondent estopped to so claim by reason of having deducted taxes, expenses, and allowance for depreciation in respect of its building when making its returns for the years 1923 and 1924?

XEN HICKS,
United States Circuit Judge.
SMITH HICKENLOOPER,
United States Circuit Judge.
ARTHUR J. TUTTLE,
United States District Judge.

For such convenience, if any, as it may be to the Supreme Court, we state briefly the conflicting considerations, developed by our study, which have led us to certify.

The record shows that the respondent occupied but one story of the twelve-story building owned by it; that the home office building had a book value of $460,000 at the close of the 1923 taxable year; that rents received from other tenants amounted to $73,620.46 for that year, and expenses, taxes, and depreciation to the sum of $70,005.18, making the value of the space occupied by the company to be included in gross income, if the method prescribed by section 245 (b) were followed, $14,784.70. For the year 1924 the book value of the home office building was found to be $494,257.97, the rents received from other tenants $71,289.21, and expenses, taxes, and depreciation, $85,918.97. For the year 1924, therefore, there was an actual loss in the operation of the building, excluding the rental value of space occupied by the company, of $14,629.76, due to slightly decreased receipt of rentals from other tenants and substantial increases in the expense of operation, and the value of the space occupied by the company to be included in gross income was increased, if the method of computation provided in section 245 (b) were followed, to the sum of $34,400.08, or almost $20,000 in excess of the value placed upon the same space for the previous year.

In one view, it may seem that the adoption of the sixteenth amendment did not in any wise limit the power of Congress to levy an excise tax upon the conduct of business in a corporate capacity (Cf. Eisner v. Macomber, 252 U.S. 189); that the present tax may be properly regarded as an excise tax measured by income as defined in the acts (Cf. Burnet v. Thompson Oil & Gas Co., 283 U.S. 301; Stanton v. Baltic Mining Co., 240 U.S. 103; Stratton's Independence, Ltd., v. Howbert, 231 U.S. 399); that permissible deductions

from gross income are purely statutory (Burnet v. Thompson Oil & Gas Co., supra); and that the company having accepted the act by continuing to do business in corporate form, and by claiming deductions for expenses, taxes and depreciation, is estopped to assail the provisions of section 245 (b) (Cf. Shepard v. Barron, 194 U.S. 553, 557; Pullman Co. v. Kansas [concurring opinion of Mr. Justice White], 216 U.S. 56, 66; Horn Silver Min. Co. v. New York, 143 U.S. 305, 313; Pierce Oil Co. v. Phoenix Ref. Co., 259 U.S. 125, 128; Grand Rapids & Ind. Ry. Co. v. Osborn, 193 U.S. 17, 29; Daniels v. Tearney, 102 U.S. 415; Oakland Sugar Mill Co. v. Fred W. Wolf Co., 118 Fed. 239, 244, C.C.A. 6; B. & O. R. Co. v. Lambert Run Coal Co., 267 Fed. 776, 781, C.C.A. 4; Owens v. Corporation Comm'n. of Okla., 41 Fed. [2] 799, 803, D.C.).

In the other view, it is to be observed that the Internal Revenue Acts of 1921 and 1924 do not purport to levy true excise taxes,
67 but the tax so levied by Section 243 is expressly declared to be "upon the net income of every life insurance company." In this view it may seem that section 245 (b) requires the inclusion in gross income of that which is not income; "that Congress cannot make a thing income which is not so in fact" (Burk-Waggoner Ass'n. v. Hopkins, 269 U.S. 110, 114; Taft v. Bowers, 278 U.S. 470, 481), and that it may validly tax under the sixteenth amendment only that which is within the definition of income as repeatedly announced by the Supreme Court (Bowers v. Kerbaugh-Empire Co., 271 U.S. 170; Eisner v. Macomber, supra), or, at least, that Congress has here in fact taxed only income or "gain" (Goodrich v. Edwards, 255 U.S. 527; Lynch v. Turrish, 247 U.S. 221); that a tax upon real estate or a tax upon the income therefrom is a direct tax which could not be laid without apportionment among the States except for the adoption of the sixteenth amendment (Pollock v. Farmers Loan & Trust Co., 157 U.S. 429, 580, 581; Brushaber v. Union Pacific R. Co., 240 U.S. 1); and that the case of National Life Ins. Co. v. United States, 277 U.S. 508, refutes both the contention that the taxes in question should properly be considered excise taxes measured by income, and, at page 520, the contention that since Congress may or may not grant deductions from gross income at pleasure, it can deny such deductions to one and give it to another.

In this view it is also to be noted that Congress has not attempted to require simply that the rental value of space occupied by an insurance company in its own building shall be returned as income, thus equalizing the burden of taxation as between companies owning their own office buildings and those companies which rent office space and which are not allowed deductions for the rentals so paid, but has provided an arbitrary and capricious method, as is claimed, for the ascertainment of such rental value, illustrated in the present case by an increase in rental value for the same space of more than 100% for the year 1924 over that fixed for 1923.

68 In United States Circuit Court of Appeals

Mandate of the Supreme Court

Filed April 3, 1933

UNITED STATES OF AMERICA, *ss:*

The President of the United States of America

To the honorable the Judges of the United States Circuit Court of Appeals for the Sixth Circuit, greeting:

Whereas, lately in the United States Circuit Court of Appeals for the Sixth Circuit, in a cause between Commissioner of Internal Revenue, petitioner, and the Independent Life Insurance Company, respondent, no. 5850, wherein certain questions of law arose which were certified by the said Circuit Court of Appeals to the Supreme Court of the United States for its opinion; as by the inspection of the certificate of the judges of the said United States Circuit Court of Appeals which was brought into the Supreme Court of the United States agreeably to the act of Congress, in such case made and provided, fully and at large appears.

And whereas, in the present term of October, in the year of our Lord one thousand nine hundred and thirty-two of the said Supreme Court, counsel for the Independent Life Insurance Company filed a motion to bring up the entire record and cause herein,

On consideration whereof, It is ordered by this court that the said motion be, and the same is hereby, denied.

69 And it is further ordered, That the certificate herein be, and the same is hereby, dismissed.

February 20, 1933.

You, therefore, are hereby commanded that such proceedings be had in such cause, as according to right and justice, and the laws of the United States, ought to be had, the said certificate notwithstanding.

Witness, the honorable CHARLES E. HUGHES, Chief Justice of the United States, the first day of April, in the year of our Lord one thousand nine hundred and thirty-three.

CHARLES ELMORE CROPLEY,
Clerk of the Supreme Court of the United States.

File No. 35259. Supreme Court of the United States, no. 562. October Term, 1932. Commissioner of Internal Revenue, vs. The Independent Life Insurance Company. Mandate.

70 In United States Circuit Court of Appeals

Order setting case for reargument

Filed April 4, 1933

It is ordered that this cause be specially set for reargument on Tuesday, May 9th, 1933.

In United States Circuit Court of Appeals

Cause reargued and submitted

May 9, 1933

Before: HICKS, HICKENLOOPER, and TUTTLE, JJ.

This cause is reargued by J. L. Monarch for petitioner and by J. A. Newman for respondent and is submitted to the court.

In United States Circuit Court of Appeals

Decree

Filed Nov. 10, 1933

APPEAL from the United States Board of Tax Appeals

This cause came on to be heard on the transcript of record from the United States Board of Tax Appeals, and was argued by counsel.

On consideration whereof, It is now here ordered, adjudged, and decreed by this court that the order or decree of the said Board of Tax Appeals in this cause be and the same is hereby, affirmed.

71 (File endorsement omitted.)

In United States Circuit Court of Appeals, Sixth Circuit

No. 5850

COMMISSIONER OF INTERNAL REVENUE, PETITIONER

v.

THE INDEPENDENT LIFE INSURANCE COMPANY, RESPONDENT

Petition to review an order of the United States Board of Tax Appeals

Opinion filed

November 10, 1933

Before HICKS and HICKENLOOPER, Circuit Judges, and TUTTLE, District Judge.

HICKS, Circuit Judge: Petition by the Commissioner of Internal Revenue to review an order of the Board of Tax Appeals adjudging

that respondent had overpaid its income taxes for the years 1923 and 1924 in the sums of $112.86 and $226.79, respectively.

Respondent is a life insurance company, and during the years 1923 and 1924 owned a twelve-story building, occupying one story and renting portions of the remainder.

The Commissioner determined a deficiency in respondent's taxes for the year 1923 in the sum of $298.97 and for the year 1924 in the sum of $1,115.65. These alleged deficiencies grew out of the following facts.

Although respondent had deducted for each year taxes, expenses, and an allowance for depreciation incurred in connection with its building, as provided in sec. 245 (a) (6) and (7) of the Revenue Acts of 1921 and 1924, it had not included in its returns of gross income for those years the rental value of the space occupied by it as required by sec. 245 (b) of each act. Sec. 245 (b) of the act of 1921 is printed in the margin.[1] Sec. 245 (b) of the act of 1924 is similar.

By the provisions of these sections, as interpreted by article 686 of Treasury Regulation 62, under the Revenue Act of 1921, and Treasury Regulation 65, under the Revenue Act of 1924, the Commissioner included in respondent's gross income $14,784.70 for 1923, and $34,400.08 for 1924, as the rental value of the space occupied by respondent in its building for those years. His action gave rise to the deficiencies complained of.

The Board found that the deficiency for each year was calculated in accordance with sec. 245 (b) as it appears, respectively, in the Revenue Acts of 1921 and 1924, but that the requirement thereof, for the inclusion in gross income of the rental value of the space occupied by respondent in its building, violated the Constitution (art. 1, sec. 2, clause 3; and art 1, sec. 9, clause 4) upon the theory that a tax upon such rental value was not an income tax but a direct tax upon real estate without apportionment.

Petitioner insists that sec. 245 (b) of each act was constitutional and that the Board was unauthorized to declare otherwise.

The court is not concerned with whether the Board of Tax Appeals was authorized to pass upon the constitutionality of these enactments. A decision by us upon that question would not decide this case. We are, however, required to consider and determine whether the decision of the Board that respondent had overpaid its income taxes for the years involved was "in accordance with law." *Revenue Act of 1926*, ch. 27, sec. 1003; *Commissioner* v. *Liberty Bank & Trust Co.*, 59 Fed. (2) 320, 324 (C.C.A. 6). In the discharge of this duty the court is called upon to determine for itself whether

[1] "Sec. 245 (b). No deduction shall be made under paragraphs (6) and (7) of subdivision (a) on account of any real estate owned and occupied in whole or in part by a life insurance company, unless there is included in the return of gross income the rental value of the space so occupied. Such rental value shall be not less than a sum which in addition to any rents received from other tenants shall provide a net income (after deducting taxes, depreciation, and all other expenses) at the rate of 4 per centum per annum of the book value at the end of the taxable year of the real estate so owned or occupied."

section 245 (b), of the acts of 1921 and 1924 respectively was a valid enactment. *Smythe* v. *Ames*, 169 U.S. 526. If it was not, the finding of the Board, which may be construed as a finding that no additional tax was due, would obviously have been correct, regardless of the power of the Board to pass upon the constitutionality of the act of Congress.

73 Prior to the Revenue Act of 1921 (ch. 136, 42 stat. 227) life insurance companies were classed, for income tax purposes, with ordinary corporations. They were required to report income from all sources with certain minor exceptions not here important. This included income from premium receipts commonly called underwriting income. The inclusion of premium receipts in gross income was found to be unsatisfactory both to the Government and to the companies because these receipts did not always represent true income. See dissenting opinion of Mr. Justice Brandeis in National Life Ins. Co. v. United States, 277 U.S. 508, 522, 523. With the approval of "Life Insurance Presidents" at their annual meeting in December 1920, Congress provided for the assessment of income taxes against insurance companies upon a new basis, embodied in sections 243, 244(a), 245 (a) and (b) of the Revenue Act of 1921, ch. 136, 42 stat. 227. Sec. 243 provides that "there shall be levied, collected, and paid for the calendar year 1921 and for each taxable year *thereafter upon the net income of every life insurance company a tax as follows* . . . ." (Italics ours.)

Sec. 244 (a) provides that the term "gross income" means the gross amount of income received during the taxable year from *interest, dividends, and rents.* (Italics ours.) Sec. 245 (a) provides the method for the determination of "net income." The pertinent provisions of section 243, 244 (a), and 245 (a) are similar in the acts of 1921 and 1924, respectively. In determining, therefore, whether the rental value of the space occupied by the life insurance company in its own building should be included in the return of gross income, an accurate conception of the terms, "income", "gross income", and "net income", are of fundamental importance.

It might be said, with a fair show of reason, that benefit in the form of actual rental value accruing to one who occupies his own building is in the nature of income from rents. But we may not adopt such conception here. We are required to follow the standard definition of income found in the sixteenth amendment and the interpretation thereof by the Supreme Court. The well-established meaning of income in this connection is found in Eisner v. Macomber, 252 U.S. 189, 207—"'Derived-from-capital'; 'the gain derived-from-capital', etc. Here we have the essential matter: not a gain accruing to capital, not a growth or increment of value in the investment; but a gain, a profit, something of exchangeable value
74 proceeding from the property, severed from the capital however invested or employed, and coming in, being 'derived', that is, received or drawn by the recipient (the taxpayer) for his

separate use, benefit, and disposal; that is income derived from property. Nothing else answers the description."

In Bowers v. Kerbaugh-Empire Co., 271 U.S. 170, 174, the court said:

"After full consideration, this court declared that income may be defined as gain derived from capital, from labor, or from both combined, including profit gained through sale or conversion of capital. Stratton's Independence v. Howbert, 231 U.S. 399, 415; Doyle v. Mitchell Brothers Co., 247 U.S. 179, 185; Eisner v. Macomber, 252 U.S. 189, 207. And that definition has been adhered to and applied repeatedly. See e.g. Merchants L. & T. Co. v. Smietanka, supra, 518; Goodrich v. Edwards, 255 U.S. 527, 535; United States v. Phellis, 257 U.S. 156, 169; Miles v. Safe Deposit Co., 259 U.S. 247, 252–253; United States v. Supplee-Biddle Co., 265 U.S. 189, 194; Irwin v. Gevit, 268 U.S. 161, 167; Edwards v. Cuba Railroad, 268 U.S. 628, 633. In determining what constitutes income substance rather than form is to be given controlling weight. Eisner v. Macomber, supra, 206."

Whatever might be said as to the power of Congress to require life insurance companies to include in their gross income the actual or fair rental value of space occupied by them in their own buildings (a question not necessary here to determine) it is manifest to us that the amount required to be added to gross income under sec. 245 (b), before deductions may be taken, is not income when measured by the rule in Eisner v. Macomber, supra, and Bowers v. Kerbaugh-Empire Co., supra. It does not represent actual gain. It is neither of exchangeable value nor is it severed from capital. It is not something received or drawn by the taxpayer for his separate use and disposal. It is simply an arbitrary figure, determined by a mathematical formula, to which must be added rents received from other tenants and from which must be deducted taxes, depreciation and all other expenses to reach a net income of 4% per annum of the book value (not actual value) of the building at the end of any given taxable year. It does not even purport to approximate the true rental value of the space occupied. It must be increased or diminished inversely, each year, to the increase or decrease of rents received. In Burk-Waggoner Ass'n v. Hopkins, 269 U.S. 110, 114, the court said: "It is true that Congress cannot make a thing income which is not so in fact." See, also, Flint v. Stone Tracy Co., 220 U.S. 108, 145.

It is here urged, as was urged in National Life Insurance Co. v. United States, supra, that the present tax is a special excise tax laid upon life insurance companies and measured by the aggregate of certain receipts by such companies; that in levying such an excise tax Congress was not acting under the sixteenth amendment, and hence, the proper definition of income as used in that amendment, is wholly immaterial; and, since the respondent has continued to do business in corporate form, it is estopped to deny the

validity of the conditions upon which Congress has said this could be done. To so hold would be to deny the obvious fact. In form and substance the Internal Revenue Acts under consideration levy income taxes and not excise taxes. Respondent has accepted no benefits under sec. 245 (b) of either act. None are in effect granted therein. It has chosen, as it had a right to, to claim deductions allowed by sec. 245 (a) (6) and (7) of each act and to resist deficiency assessments founded upon the compulsory inclusion in gross income of that which cannot in any sense be regarded as income. The record fails to disclose that respondent has acquiesced in the provisions of these sections or recognized them as valid. See Frost v. Corporation Commission, 278 U.S. 515, 528. We therefore conclude that the inclusion of the indicated items in respondent's gross income for 1923 and 1924, respectively, as the rental value of the space occupied by it in its building, was in effect the taxation of something nontaxable (Evans v. Gore, 253 U.S. 245; Miles v. Graham, 263 U.S. 501) and was invalid.

It is said that the purpose of sec. 245 of each act was, not to include in gross income that which was not income, but to limit the deductions of taxes and other expenses paid with respect to real estate owned by life insurance companies, and of the allowance for exhaustion and obsolescence granted in sec. 245 (a) (6) and (7) of each act. It is urged that this may be done because deductions are statutory, and, although income is controlled by the Constitution, Congress may grant deductions or withhold them entirely or limit the amounts thereof.

The same argument was advanced in National Life Insurance Co. v. United States, supra, but the court there said (277 U.S., p. 520):

> "The suggestion that as Congress may or may not grant
> 76 deductions from gross income at pleasure, it can deny to one and give to another, is specious, but unsound."

Congress may of course allow to all life insurance companies the deductions granted in sec. 245 (a) (6) and (7) but having done so it cannot then say that it will deny these same deductions to those life insurance companies which own and occupy in whole or in part their own real estate unless they submit to taxation upon income which is nonexistent.

No claim is made that sec. 245 (a) (6) and (7) of the acts under consideration, by virtue of which respondent took deductions, are unconstitutional. Both the acts, 1921 and 1924, contain the usual section to the effect that if any of their provisions are held invalid, the remainder shall not be affected thereby.

The order of the Board of Tax Appeals is affirmed.

Dissenting opinion

TUTTLE, District Judge, dissenting: I cannot agree with the conclusion reached by a majority of the court nor with the views resulting in such conclusion, as expressed in the majority opinion.

It seems to me entirely clear that the statutory provisions here involved are subject to none of the constitutional objections urged by the taxpayer and upheld by the court. There are no constitutional prohibitions which prevented Congress from enacting a statute, in proper form, which would impose either an excise tax or an income tax, or both, upon life insurance companies. There is no property or income from property involved in this case which is exempted by the Constitution from taxation as was the fact in National Life Insurance Co. v. United States, 277 U.S. 508. That case, therefore, is, in my opinion, not applicable here. Congress, pursuant to the power conferred upon it by the sixteenth amendment, has seen fit by this act to impose an income tax upon certain income of life insurance companies. No effort has been made in the act to impose an excise tax. Congress, having decided, as it had the power to do, to exempt life insurance companies from an excise tax, and from any tax on income from the life insurance business proper, very properly and justly determined and enacted that, in computing the net income to be taxed, the life insurance companies should not be permitted to make deductions from gross income received from property previously accumulated (interest, dividends, and rents) unless such deductions were decreased by "the rental value", as defined in the act, of "any real estate owned and occupied" by the company. This is the real purpose and
77 result of the act, when considered and construed in its entirety. Obviously, Congress recognized that inasmuch as an effort was being made to tax only the income from property already acquired it would not be fair to permit the companies, so exempt from excise taxes and exempt from taxes on income from the life insurance business proper, to use this real estate without taking such use into account in making deductions from the gross income which were subjected to the provisions of this act. It cannot, of course, be doubted that in framing a statute to impose an income tax, Congress could impose such tax upon gross income without allowing any deductions or could allow such reasonable deductions as it deemed proper in determining the net income to be taxed.

The purpose and results of the act in question seem plain. It imposes a tax upon actual income from certain property, namely, interest, dividends, and rents, without including as income any rental value of the real estate occupied by the taxpayer company, and permits a deduction, from such gross income, which deduction takes into account the use of real estate owned and occupied by such company. This was a constitutional method of accomplishing the desired results. Section 245(b) denies deductions from gross income unless "the rental value," as defined in such section, of the afore-mentioned real estate is taken into account in computing the amount of such deductions. This is no more objectionable, from a constitutional standpoint, because it is couched in this permissive

language than it would have been if the language providing for such conditional deduction had been imperative. The majority opinion holds sec. 245(b) unconstitutional on the ground that it provides for including "the rental value," as there defined, of the space occupied by the company, in the return of gross income. I do not dissent on the ground that such "rental value," however defined or computed, is taxable as income, or constitutes income, but on the ground that it is not in reality included in gross income, nor taxed, by this act. Construing, as we must, sections 245(a) and 245(b), together and as a whole, and considering them from the standpoint of the results sought and obtained, they do not impose any tax upon "the rental value," or upon any part of the value, of the space occupied by the taxpayer, but in mathematical language provide, in substance, that if the gross deduction permitted by the act is claimed then that gross deduction must be reduced by the amount of such "rental value," as therein defined. I construe the language of sec. 245(b), which directs that if the allowed deduction is claimed 78 the so-called "rental value" shall be included "in the return of the gross income", as a mere direction as to manner of computation rather than a matter of substance. For the purpose of reducing to an algebraic formula one of the mathematical methods by which Congress might have proceeded to accomplish the object intended, let us assume that A represents the gross income, which the act defines as the "gross amount of income received from interest, dividends and rents." Let B represent "the rental value" of the "real estate owned and occupied" by the company. Let C represent the gross conditional deduction permitted by the act for taxes, expenses and depreciation. It seems plain that there is nothing in the Constitution which would have prevented Congress from enacting a tax law which provided that the net amount of income to be taxed was to be determined by taking A, the gross income, and deducting therefrom a sum to be determined by subtracting B, the rental value of the property used by the company, from C, the gross deduction conditionally permitted. The algebraic formula for this method would have been $A-(C-B)$. If we reduce this formula to its most simple algebraic form, it becomes $A+B-C$, which is the identical formula provided by the statute under consideration. Instead of providing a formula which would require a determination of the permitted deduction by subtracting B, the rental value of the property used by the company, from C, the gross deduction conditionally permitted, Congress provided the more simple formula which takes A, the gross income, and, if deduction is claimed, adds thereto B, the rental value, and then deducts C, the gross conditional deduction. This gives us the same formula, $A+B-C$. The two formulae are identical, in theory of taxation and in results. Congress had the power to impose a tax upon A, the gross income, and to provide for C, the gross deduction permitted by the act, and to reduce that gross deduction by subtracting therefrom B, the rental value of the property used. The resulting remainder to be taxed

is the same whether we add B, the rental value, to the subtrahend A or subtract it from the minuend C. Neither imposes a tax upon the use or value of real estate. Both take the "rental value" of such use, as measured by the act, into account in determining the deduction permitted. The only difference is in the manner of doing the same arithmetical problem. The act provides for adding A and B and then subtracting C, which, it seems to me, as it evidently did to Congress, is more simple than subtracting B from C and then subtracting the remainder so obtained from A.

79 The power of Congress and the constitutionality of its enactments should be determined not upon any narrow considerations but in the light of the substance of the statute, having in mind the object intended and the practical results accomplished. The meaning and purpose of this act in its entirety, including sec. 245 (b), seem to me plain and fully within the powers of Congress. In the final analysis, by sections 245 (a) and 245 (b) of the statute Congress permitted, without requiring, the deduction, from certain gross income of life insurance companies, of certain items of expense as reduced by a certain figure. That figure was referred to, in sec. 245 (b), as the "rental value" of the real estate owned and occupied by the taxpayer but its maximum was determined by a certain formula of computation prescribed by the statute. As, however, the last-mentioned figure does not, and is not intended to, represent income, but is used merely as a means of measurement of the amount of the deduction permitted, it is wholly immaterial whether it accurately represents rental value or is merely an arbitrary figure having no relation to the real rental value. Of course, even if it did actually represent rental value that would not meet the constitutional objection urged against its inclusion in, and as, income taxable under the sixteenth amendment, for the obvious reason that rental value does not constitute income. Used, however, merely for the purpose of measuring the amount of the permissible deduction in question, it does not, in my opinion, appear to be unreasonable or unfair, and I know of no reason why Congress could not, in its discretion and judgment, adopt it as part of the basis for computation of such deduction. It is, of course, obvious that these sections of the statute do not require, even indirectly, the taxpayer to pay more than the prescribed income tax upon any property except income, inasmuch as the net conditional deduction here allowed need not be claimed by the taxpayer, but may be entirely waived, in which event the latter will pay such income tax upon gross income without any deduction to which payment he can have no constitutional objection.

For the reasons stated, I reach the conclusion that the order of the Board of Tax Appeals should be set aside and the cause remanded for further proceedings not inconsistent with this opinion.

80 [Clerk's certificate to foregoing transcript omitted in printing.]

81 Supreme Court of the United States

Order allowing certiorari

Filed February 5, 1934

The petition herein for a writ of certiorari to the United States Circuit Court of Appeals for the Sixth Circuit is granted. And it is further ordered that the duly certified copy of the transcript of the proceedings below which accompanied the petition shall be treated as though filed in response to such writ.

(Endorsement on cover:) File no. 38,292. U.S. Circuit Court of Appeals, Sixth Circuit. Term no. 689. Guy T. Helvering, Commissioner of Internal Revenue, petitioner, vs. The Independent Life Insurance Company. Petition for a writ of certiorari and exhibit thereto. Filed December 29, 1933. File no. 689 O.T. 1933.

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In the Supreme Court of the United States

OCTOBER TERM, 1933

No. —

GUY T. HELVERING, COMMISSIONER OF INTERNAL REVENUE, petitioner

v.

THE INDEPENDENT LIFE INSURANCE COMPANY

PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES CIRCUIT COURT OF APPEALS FOR THE SIXTH CIRCUIT

The Solicitor General, on behalf of Guy T. Helvering, Commissioner of Internal Revenue, prays that a writ of certiorari issue to review the judgment of the Circuit Court of Appeals for the Sixth Circuit entered in the above cause on November 10, 1933, affirming a decision of the United States Board of Tax Appeals.

OPINIONS BELOW

The opinion of the Board of Tax Appeals (R. 23–48) is reported in 17 B.T.A. 757. The opinion of the Circuit Court of Appeals (R. 68–75) is not yet reported.

JURISDICTION

The judgment of the Circuit Court of Appeals was entered November 10, 1933. (R. 67.) The jurisdiction of this Court is invoked under Section 240 (a) of the Judicial Code, as amended by the Act of February 13, 1925.

QUESTION PRESENTED

Whether it is within the constitutional power of Congress to deny to life insurance companies the right to deduct from gross income, in computing taxable net income, taxes, expenses, and depreciation with respect to real estate owned and occupied in whole or in part by them, except upon condition that they include in net income, as the rental value of the space so occupied, an amount which when added to the rents received from other tenants will provide a net income at the rate of not less than 4 percent per annum on the book value of such real estate.

STATUTES AND REGULATIONS INVOLVED

The statutes and regulations involved will be found in the Appendix, *infra,* pp. 7–9.

STATEMENT

The following is a summary of the facts as agreed upon by the parties and found by the Board of Tax Appeals (R. 23–26):

The respondent is a life insurance company with its home office located at Nashville, Tennessee. (R. 23.)

During the years 1923 and 1924 the respondent owned a twelve-story building in Nashville, of which it occupied about one story as its home office. It rented such portions of the remainder of the building as it could and received gross rentals of $73,620.48 and $71,289.21 during the years 1923 and 1924, respectively. (R. 23, 25, 26.)

In 1923 the taxes, expenses, and depreciation with respect to the building aggregated $70,005.18, and the book value of the building was $460,000. (R. 25.) For the year 1924 the taxes, expenses, and depreciation amounted to $85,918.97, and the book value of the building was $494,257.97. (R. 26.) In computing its taxable net income for those years the respondent deducted from gross income the taxes, expenses, and depreciation with respect to the building, but failed to include in gross income the rental value of the space occupied by it, as required by Section 245 (b) of the Revenue Acts of 1921 and 1924. The Commissioner determined that the rental value of such space should have been returned as a part of gross income and on January 25, 1927, mailed to the respondent a notice of proposed deficiency assessments for the years 1923 and 1924 in the amounts of $298.97 and $1,115.65, respectively. (R. 23, 24.) The method by which these deficiencies were computed is shown on pages 25 and 26 of the record.

The Board of Tax Appeals found that the computation of the Commissioner was correct under the law (R. 32), but held that Section 245 (b) of the Revenue Acts of 1921 and 1924 was unconsti-

tutional, and entered an order determining overpayments of $112.86 for 1923 and $226.79 for 1924. (R. 49.) Three members dissented on the ground that the Board is without authority to declare an Act of Congress unconstitutional.

On December 14, 1932, the Circuit Court of Appeals certified to this Court questions regarding the constitutionality of Section 245 (b) and the right of the respondent to challenge the validity of that section. (R. 63–66.) On February 20, 1933, the certificate was dismissed. 288 U.S. 592. (R. 66–67.) Thereafter the Circuit Court of Appeals, one judge dissenting, held that the statute was invalid and that the respondent was not estopped to question its validity.

SPECIFICATION OF ERRORS TO BE URGED

The Circuit Court of Appeals erred:

1. In holding that Section 245 (b) of the Revenue Acts of 1921 and 1924 is invalid.

2. In holding that Section 245 (b) of the Revenue Acts of 1921 and 1924 imposes a direct tax upon real estate.

3. In holding that Congress is without power to limit deductions to those expenses connected with the earning of taxable income.

4. In holding that the tax imposed upon life insurance companies by the Revenue Acts of 1921 and 1924 is not a special excise tax.

5. In holding that the respondent is not estopped to question the validity of Section 245 (b) of the Revenue Acts of 1921 and 1924.

6. In failing to hold that in any event the deductions taken by the respondent under Section 245 (a) (6) and (7) of the Revenue Acts of 1921 and 1924 should be adjusted to give effect, in so far as possible, to the manifest purpose of Congress to permit such deductions only upon the conditions and to the extent specified in subdivision (b) of that section.

7. In affirming the decision of the Board of Tax Appeals.

REASONS FOR GRANTING THE WRIT

1. The decision below is in direct conflict with the decisions of the Circuit Court of Appeals for the Seventh Circuit in *Commissioner* v. *Lafayette Life Insurance Co.*, 67 F. (2d) 209, and *Commissioner* v. *Rockford Life Insurance Co.*, 67 F. (2d) 213.

2. The court below has held unconstitutional an important provision of the Federal revenue laws. Section 245 (b) of the Revenue Acts of 1921 and 1924 (*infra*, p. 8) is an integral part of the special plan devised by Congress for the taxation of life insurance companies. Such companies are taxed only on their investment income as distinguished from income derived from underwriting activities, and are consequently permitted to deduct from gross income only such expenses as are fairly chargeable against investment income. Subdivision (b) of Section 245 was designed to carry out this plan by limiting deductions with respect to real estate to expenses relating to that part of the

company's real estate which is held as an investment. The decision below holds in effect that it is not within the power of Congress to correlate deductions with taxable income in this manner.

3. The question presented is one of general importance, affecting as it does all life insurance companies which maintain offices in their own buildings. The Revenue Acts of 1926 and 1928 contain provisions identical with Section 245 (b) of the 1921 and 1924 Acts.[1] Numerous claims for refund have been filed following the decision of the Board of Tax Appeals in the instant case, and several cases involving the question are pending in the courts. It is important that the conflict of authority be resolved for the guidance of the courts and of the officers charged with the administration of the law.

Wherefore, it is respectfully submitted that this petition for a writ of certiorari should be granted.

J. CRAWFORD BIGGS,
Solicitor General.

DECEMBER 1933.

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[1] See Section 245 (b) of the Revenue Act of 1926, c. 27, 44 Stat. 9, 47; Section 203 (b) of the Revenue Act of 1928, c. 852, 45 Stat. 791, 844.

In Section 203 (b) of the Revenue Act of 1932, c. 209, 47 Stat. 169, 225, the law was changed to limit the deduction to "an amount which bears the same ratio to such deduction (computed without regard to this subsection) as the rental value of the space not so occupied bears to the rental value of the entire property." This change resulted from the decision of the Board of Tax Appeals in the instant case, but was made "without regard to the legality of the present provisions." See S.Rep. No. 665, 72d Cong., 1st Sess., p. 36.

APPENDIX

STATUTES AND REGULATIONS INVOLVED

The Revenue Act of 1921, c. 136, 42 Stat. 227, 261, provides in part:

> SEC. 243. That in lieu of the taxes imposed by sections 230 and 1000 and by Title III, there shall be levied, collected, and paid for the calendar year 1921 and for each taxable year thereafter upon the net income of every life insurance company a tax as follows:
>
> (1) In the case of a domestic life insurance company, the same percentage of its net income as is imposed upon other corporations by section 230;
>
> * * * * *
>
> SEC. 244. (a) That in the case of a life insurance company the term "gross income" means the gross amount of income received during the taxable year from interest, dividends, and rents.
>
> * * * * *
>
> SEC. 245. (a) That in the case of a life insurance company the term "net income" means the gross income less—
>
> * * * * *
>
> (6) Taxes and other expenses paid during the taxable year exclusively upon or with respect to the real estate owned by the company, not including taxes assessed against local benefits of a kind tending to increase the value of the property assessed, and not

including any amount paid out for new buildings, or for permanent improvements or betterments made to increase the value of any property. The deduction allowed by this paragraph shall be allowed in the case of taxes imposed upon a shareholder or member of a company upon his interest as shareholder or member, which are paid by the company without reimbursement from the shareholder or member, but in such cases no deduction shall be allowed the shareholder or member for the amount of such taxes;

(7) A reasonable allowance for the exhaustion, wear and tear of property, including a reasonable allowance for obsolescence. In the case of property acquired before March 1, 1913, this deduction shall be computed upon the basis of its fair market price or value as of March 1, 1913;

* * * * *

(b) No deduction shall be made under paragraphs (6) and (7) of subdivision (a) on account of any real estate owned and occupied in whole or in part by a life insurance company unless there is included in the return of gross income the rental value of the space so occupied. Such rental value shall be not less than a sum which in addition to any rents received from other tenants shall provide a net income (after deducting taxes, depreciation, and all other expenses) at the rate of 4 per centum per annum of the book value at the end of the taxable year of the real estate so owned or occupied.

* * * * *

The pertinent provisions of Sections 243 (U.S.C., Title 26, Sec. 1001), 244 (U.S.C., Title 26, Sec. 1003), and 245 (U.S.C., Title 26, Sec. 1004) of the Revenue Act of 1924, c. 234, 43 Stat. 253, 289,

are substantially identical with the provisions quoted above.

Article 686 of Treasury Regulations 62 (promulgated under the Revenue Act of 1921) provides:

> ART. 686. *Home office properties.*—No deduction shall be made for any taxes, expenses, or depreciation on account of any real estate owned and occupied in whole or in part by a life-insurance company unless there is included in the return of gross income the rental value of the space so occupied. Such rental value shall not be less than a sum which in addition to any rents received from other tenants shall provide a net income (after deducting taxes, depreciation, and other expenses) at the rate of 4 per cent per annum of the book value at the end of the taxable year of the real estate so owned and occupied. For example, if the book value of a parcel of real estate owned and occupied in whole or in part by the company is $1,000,000, the rents received from other tenants $30,000, taxes and expenses $40,000, and depreciation $20,000, the company would have to include in its gross income a sum not less than $70,000 ($40,000 taxes and expenses, plus $20,000 depreciation, minus $30,000 rents from tenants, plus 4 per cent of $1,000,000) as the rental value of the space occupied by it in order to avail itself of the deductions of $40,000 and $20,000. In any case the rents received from other tenants must be included in gross income.

Article 686 of Regulations 65, promulgated under the Revenue Act of 1924, is substantially the same as that set forth above.

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In the Supreme Court of the United States

OCTOBER TERM, 1933

No. 689

GUY T. HELVERING, COMMISSIONER OF INTERNAL REVENUE, petitioner

v.

THE INDEPENDENT LIFE INSURANCE COMPANY

ON A WRIT OF CERTIORARI TO THE UNITED STATES CIRCUIT COURT OF APPEALS FOR THE SIXTH CIRCUIT

BRIEF FOR THE PETITIONER

OPINIONS BELOW

The findings and opinion of the United States Board of Tax Appeals (R. 15) are reported in 17 B.T.A. 757. The opinion of the Circuit Court of Appeals (R. 48) is reported in 67 F. (2d) 470.

JURISDICTION

The judgment of the Circuit Court of Appeals was entered November 10, 1933 (R. 48). The petition for a writ of certiorari was filed December 29, 1933, and was granted February 5, 1934 (R. 56). The jurisdiction of this Court rests upon Section 240 (a) of the Judicial Code, as amended by the Act of February 13, 1925.

QUESTIONS PRESENTED

Section 245 (b) of the Revenue Acts of 1921 and 1924 provides that life insurance companies may deduct the taxes, expenses, and depreciation upon real estate owned and in any part occupied by them only upon the condition that they include in gross income an amount representing the rental value of the space so occupied. The questions presented are:

1. Whether this condition results in the imposition of a direct tax which is invalid for want of apportionment.

2. Whether the respondent, having availed itself of the privilege extended by the statute, will be permitted to repudiate the condition upon which that privilege is granted.

STATUTES AND REGULATIONS INVOLVED

The statutes and regulations involved will be found in Appendix A, *infra*, pp. 35–38.

STATEMENT

The following is a summary of the facts as agreed upon by the parties and found by the Board of Tax Appeals (R. 16–19):

The respondent is a life insurance company with its home office located at Nashville, Tennessee (R. 16).

During the years 1923 and 1924 the respondent owned a twelve-story building in Nashville, of which it occupied about one story as its home office. It rented such portions of the remainder of the

building as it could, and received gross rentals of $73,620.48 and $71,289.21 during the years 1923 and 1924, respectively (R. 16, 18, 19).

In 1923 the taxes, expenses, and depreciation with respect to the building aggregated $70,005.18, and the book value of the building was $460,000 (R. 18). For the year 1924 the taxes, expenses, and depreciation amounted to $85,918.97, and the book value of the building was $494,257.97 (R. 18). In computing its taxable net income for those years the respondent deducted from gross income the taxes, expenses, and depreciation with respect to the building, but failed to include in gross income the rental value of the space occupied by it, as required by Section 245 (b) of the Revenue Acts of 1921 and 1924. The Commissioner determined that the rental value of such space should have been returned as a part of gross income and on January 25, 1927, mailed to the respondent a notice of proposed deficiency assessments for the years 1923 and 1924 in the amounts of $298.97 and $1,115.65, respectively (R. 16). The method by which these deficiencies were computed is shown on pages 18 and 19 of the record.

The Board of Tax Appeals found that the computation of the Commissioner was correct under the law (R. 22), but held that Section 245 (b) of the Revenue Acts of 1921 and 1924 was unconstitutional, and entered an order determining overpayments of $112.86 for 1923 and $226.79 for 1924 (R. 34). Three members dissented on the ground that

the Board is without authority to declare an Act of Congress unconstitutional (R. 33–34).

On December 14, 1932, the Circuit Court of Appeals certified to this Court questions regarding the constitutionality of Section 245 (b) and the right of the respondent to challenge the validity of that section (R. 43–46). On February 20, 1933, the certificate was dismissed, 288 U.S. 592 (R. 47). Thereafter the Circuit Court of Appeals, one judge dissenting, held that the statute was invalid and that the respondent was not estopped to question its validity.

SPECIFICATION OF ERRORS TO BE URGED

The Circuit Court of Appeals erred:

1. In holding that Section 245 (b) of the Revenue Acts of 1921 and 1924 is invalid.

2. In holding that Section 245 (b) of the Revenue Acts of 1921 and 1924 imposes a direct tax upon real estate.

3. In holding that Congress is without power to limit deductions to those expenses connected with the earning of taxable income.

4. In holding that the tax imposed upon life insurance companies by the Revenue Acts of 1921 and 1924 is not in substance a special excise tax.

5. In holding that the respondent is not estopped to question the validity of Section 245 (b) of the Revenue Acts of 1921 and 1924.

6. In failing to hold that in any event the deductions taken by the respondent under Section

245 (a) (6) and (7) of the Revenue Acts of 1921 and 1924 should be adjusted to give effect, in so far as possible, to the manifest purpose of Congress to permit such deductions only upon the condition and to the extent specified in subdivision (b) of that section.

7. In affirming the decision of the Board of Tax Appeals.

SUMMARY OF ARGUMENT

I

The statute involved, in effect, limits the allowance for expenses of operating a building which is occupied in part by an insurance company to those expenses which are attributable to the portion of the building devoted to the production of investment income. Since no other income is taxed, it was the purpose of Congress to prevent the investment income from being reduced by expenses of producing nontaxable income.

There can be no doubt of the power of Congress to deny or limit deductions, and the legislative history of the statute shows that Congress adopted the present method, after careful consideration, as the most workable method of achieving the desired result. Apparently the way chosen was approved by the insurance companies. As a consequence the statute allows the deduction of the expenses of operating the entire building and accomplishes the limitation by requiring the taxpayer who claims such deductions to report the rental value of the space occupied by it as gross income.

The attack upon the constitutionality of the statute amounts to no more than a criticism of the method by which Congress has exercised an admitted power. The result does not destroy guaranteed exemptions or put a burden upon one entitled to the exemption which he would not otherwise bear, as in *National Life Ins. Co.* v. *United States*, 277 U.S. 508. No direct tax is laid upon rental value of the property. Taxing the rental value is not the object at which the statute is aimed, and the fact that the rental value of space occupied is incidentally and casually affected is immaterial.

The tax upon life insurance companies is not the ordinary tax upon all income but a special tax upon a limited class of income. Despite its inclusion in an income-tax statute it is in the nature of a special excise tax upon life insurance companies. Were it expressly called an excise it would not be invalid because measured in part by something not directly taxable, and no necessity for apportionment would exist. In determining the validity of a statute its form should not control.

The respondent did not except to the action of the Commissioner on the ground that the statute violates the Fifth Amendment, and no sufficient basis for consideration of that question appears in the record.

II

The taxpayer claimed and has received the benefit of deductions which are conditioned upon the inclusion of the rental value in gross income. It

is well settled that one who has received a benefit under a statute will not be heard to assail it. Constitutional questions may be waived as well as others. The application of that rule to this case would result in limiting the deductions in the way Congress intended. On the other hand, if the rule is not applied and the statute is held invalid, the investment income which Congress intended to tax will be reduced by some expenses which contributed to the production of nontaxable income.

If the provision under attack is held invalid, then the provision allowing deductions for real estate expenses must fall, insofar as it applies to home office property, for the provisions are inseparable. Then a life insurance company would be entitled to no deductions for expenses connected with its office building.

ARGUMENT

I

THE PURPOSE AND EFFECT OF THE CHALLENGED STATUTE WERE MERELY TO CORRELATE THE DEDUCTIONS WITH THE LIMITED CLASSES OF INCOME TO BE TAXED. THIS METHOD OF EXERCISING AN ADMITTED POWER DOES NOT CONVERT THE TAX INTO A DIRECT TAX WHICH IS INVALID

The statute here involved has been attacked upon the sole ground that it levies a direct tax which is not apportioned (R. 4, 14, 15). The decision of the Board of Tax Appeals went upon that ground (R. 32, 33). While the court below in terms reserved the question whether Congress might require the inclusion in gross income of the actual or fair rental value of the space occupied and based its decision

on the supposed arbitrariness of the formula prescribed by the statute (R. 51), its reasoning and final conclusion seem to have been the same as those of the Board (R. 50–52).[1] The effect of the decisions below would seem to be to focus attention almost exclusively upon that part of Section 245 (b) which requires the inclusion in gross income of the rental value of space occupied, as though that were the only provision necessary to be considered. It is not enough, we submit, to inquire whether benefit accruing to one who occupies his own building is income within the meaning of the Sixteenth Amendment. Clearly Congress did not intend that it be so regarded, or that it should be taxed as income. Section 245 (b) is but a part of a harmonious plan for the taxation of life insurance companies, drawn with reference to the peculiar nature of their business. When the plan is considered as a whole, it will be seen that Section 245 (b) had as its purpose the correlation of deductions with the limited class of income to be taxed. More specifically, the object of Section 245 (b) was simply to prevent the reduction of taxable income by the expenses of producing nontaxable income.

Considering the statute in the light of this purpose, the Circuit Court of Appeals for the Seventh

[1] It was contended in the court below that the Board of Tax Appeals, as an administrative agency of the Government, is without authority to declare a statute unconstitutional. Three members of the Board dissented on that ground (R. 33). The court below, however, held that there was no necessity for its deciding the question (R. 49).

Circuit recently said in *Commissioner* v. *Lafayette Life Ins. Co.*, 67 F. (2d) 209, 212:

> Accepting as we do this theory of the act and giving full weight to the significant fact that the act limits the taxpayer's right to claim a deduction rather than lays a tax upon the taxpayer, we see no reason for the contention that the act is unconstitutional.

In that case the Circuit Court of Appeals reversed a decision of the Board of Tax Appeals and held that Section 245 (b) of the Revenue Act of 1926 was a valid and constitutional enactment. The pertinent provisions of the Revenue Act of 1926 are the same as those of the 1921 and 1924 Acts here involved, and therefore the decision in the *Lafayette* case supports our position in the case at bar. No application for certiorari was made in that case, but *Commissioner* v. *Rockford Life Ins. Co.*, 67 F. (2d) 213 (C.C.A. 7th), decided at the same time as and upon the authority of the *Lafayette* case, is now pending before this Court, No. 722, October Term, 1933, and is assigned for argument immediately following the instant case.

The end which Congress desired to achieve in adopting this legislation is perfectly apparent. Prior to the Revenue Act of 1921 life insurance companies were taxed upon the same basis as other corporations. This proved unsatisfactory both to the insurance companies and to the Government, and accordingly Congress adopted in the Revenue

Act of 1921 an entirely new plan. In form the tax was an income tax, but it was imposed upon a net income defined with special reference to the peculiar characteristics of the business of life insurance. The term "gross income" was limited to the income received from interest, dividends, and rents; premiums and capital gains were omitted (Sec. 244 (a), Revenue Acts of 1921 and 1924, *infra*, pp. 35, 37), and certain deductions were permitted in computing the net income subject to tax. Among the deductions allowed were taxes paid on real estate and a reasonable allowance for exhaustion, wear and tear, and obsolescence (Sec. 245 (a) (6) and (7), *infra*, pp. 35–36).

Section 245 (b) of the Revenue Acts of 1921 and 1924, which is here brought into question, provides:

> No deduction shall be made under paragraphs (6) and (7) of subdivision (a) on account of any real estate owned and occupied in whole or in part by a life insurance company unless there is included in the return of gross income the rental value of the space so occupied. Such rental value shall be not less than a sum which in addition to any rents received from other tenants shall provide a net income (after deducting taxes, depreciation, and all other expenses) at the rate of 4 per centum per annum of the book value at the end of the taxable year of the real estate so owned or occupied.

The petitioner owned a twelve-story building, and during the taxable years 1923 and 1924 occu-

pied one story and rented portions of the remainder. In its tax returns for the years 1923 and 1924 it claimed deductions under Section 245 (a) (6) and (7) but failed to include in its gross income the rental value of the space occupied by it, as required by Section 245 (b) as a condition precedent to taking the said deductions.

By its express provisions Section 245 (b) is applicable only where the taxpayer claims deductions under Section 245 (a) (6) or (7). In such event, Section 245 (b) makes the taking of the deductions conditional upon the inclusion in gross income of the rental value of the space owned and occupied by the taxpayer. The provision in question is thus a limitation upon the deductions. Without such a limitation the whole expense of maintaining the building would be charged against the taxable income, with the result that expenses contributing to the earning of the underwriting income which is not taxed would serve to reduce the investment income which is taxed. There is no compulsion involved, for the taxpayer has an option and is not required to report or account for the rental value of the space occupied by it unless it decides to claim the deductions. In each case an insurance company is free to weigh the practical advantage to it involved in exercising the option provided by the statute.

It is clear from the legislative history of the statute that the aim of Congress was to tax only the *investment* income of life insurance companies,

as distinguished from their underwriting income, and to tax such investment income only to the extent that it exceeded 4 percent of the legal reserves.[2] To avoid distortion of this special class of income, Congress determined to limit deductions to those expenses connected with the earning of the income which was to be taxed, and to deny deductions for expenses in producing underwriting income which was not to be taxed. H.Rep. No. 350, 67th Cong., 1st Sess., p. 14; S.Rep. No. 275, 67th Cong., 1st Sess., p. 20.[3]

The Committee hearings (*infra*, p. 44) show that it was represented to Congress by the Treasury Department, after consultation with the life insur-

[2] Section 245 (a) (2) in terms permits the deduction from gross income of an amount equal to the excess, if any, of 4 percent of the mean of the reserve funds over the interest received on tax-exempt securities. This Court, however, held in *National Life Ins. Co.* v. *United States*, 277 U.S. 508, that the reserve deduction could not be thus limited. Accordingly, the 4 percent is now allowed in full.

[3] The changes in the method of taxing life insurance companies embraced in the Revenue Act of 1921 were worked out after consultation with such companies, and with the approval of most of them, R. 50. See dissenting opinion of Mr. Justice Brandeis in *Nat'l Life Ins. Co.* v. *United States*, 277 U.S. 508, 522. As pointed out in that opinion the provisions in the 1921 Act were based upon the same plan which had been embodied in a Senate Bill in 1918 which was not passed. Section 245 (b) as adopted in 1921 was not contained in the Senate Bill but was included in the 1921 Act following hearings set forth in part, *infra*, p. 39. It appears from those hearings that this portion of the Act, like those included in the rest of the plan, had the approval of the life insurance companies.

ance companies, that it would be impracticable to make a satisfactory apportionment between expenses related to the production of investment income and those related to the production of underwriting income, principally because of the difficulty of determining the rental value of the space occupied by the two departments of the business. Apportionment would be further complicated in those cases where a portion of the building is actually rented to outsiders, thus resulting in the immediate production of investment income in the form of rents.

It is apparent, therefore, that Congress thought, or at least had reason to think, that any system of apportioning the expenses between those applicable to the production of taxable and nontaxable income involved difficulties so great that it would be simpler and more satisfactory[4] to all concerned to use instead the method which was finally adopted.[5] Concededly the deductions thus com-

[4] Apparently the method selected was regarded as satisfactory by the insurance companies for many years, because we are informed by the Treasury Department that no claims for refund of taxes paid were filed until 1929, after the Board declared the section unconstitutional, and that many companies prior to that year had computed their taxes by including the rental value of space occupied by them pursuant to Section 245 (b).

[5] The provisions of Section 245 (b) were continued under the Revenue Acts of 1926, c. 27, 44 Stat. 9 (U.S.C. App., Title 26, Sec. 1004), and 1928, c. 852, 45 Stat. 791. Section 245 (b) of the former and Section 203 (b) of the latter

puted will not, in most cases, represent with complete accuracy the expenses actually attributable to the earning of investment income. It is equally clear, on the other hand, that to permit the deduction of all expenses would bring about a serious distortion of true investment income, especially in

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The provision was substantially changed in the Revenue Act of 1932, c. 209, 47 Stat. 169, Section 203 (b) of which provides (U.S.C. Sup. VI, Title 26, Sec. 203):

> *Rental value of real estate.*—The deduction under subsection (a) (6) or (7) of this section on account of any real estate owned and occupied in whole or in part by a life insurance company, shall be limited to an amount which bears the same ratio to such deduction (computed without regard to this subsection) as the rental value of the space not so occupied bears to the rental value of the entire property.

The change was made in the Senate, and the reasons for it are stated in the Report of the Senate Finance Committee as follows (S.Rept. No. 665, 72d Cong., 1st Sess., p. 36):

> SEC. 203 (b). *Rental value of real estate.*—Under existing law, a life-insurance company is required, as a condition to the allowance of the deductions for depreciation, taxes, and other expenses pertaining to real estate owned and occupied by it, to include in its gross income the rental value of the space occupied by it; such rental value must be not less than a sum which, together with rents from other tenants, will yield a net return of 4 percent of the book value of the real estate. The Board of Tax Appeals has held that this limitation or condition upon the deduction is unconstitutional, and that the company may still deduct the entire amount of depreciation, taxes, and other expenses upon the whole property notwithstanding there is included in gross income, rent from only a part of the property. Without regard to the legality of the present provisions, your committee believes that these provisions would operate somewhat severely in the present depressed condition of real estate, and that it is more equitable merely to disallow so much of these deductions as pertain to the part of the property which is occupied by the company than to allow such deductions in full upon condition of including in

those cases where the company occupies all or a substantial part of the building.[6] The necessity for some adjustment is apparent, and accordingly it cannot be said that the end sought was anything but reasonable. The method selected to achieve that end was one which was at the time conceived by all to be the most practicable. The purpose being a legitimate one, we submit that it was for Congress to determine the means by which it was to be accomplished.

It is settled that no taxpayer is entitled as a matter of right to deductions, and that Congress may deny them altogether or place limitations upon the amounts to be allowed. *Anderson* v. *Forty-Two Broadway Co.*, 239 U.S. 69; *Stanton* v. *Baltic Mining Co.*, 240 U.S. 103; *Von Baumbach* v. *Sargent Land Co.*, 242 U.S. 503; *Clarke* v. *Haberle Brewing Co.*, 280 U.S. 384; *Burnet* v. *Thompson Oil & Gas Co.*, 283 U.S. 301, 304.

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gross income a more or less arbitrary determination of rental value.

The bill as reported accordingly provides for the allowance of a proportionate part of the depreciation, taxes, and other expenses pertaining to real estate owned and occupied by the company, to be determined by the proportion which the rental value of the space not occupied by the company bears to the rental value of the entire property. Such rental value, instead of being fixed by a definite statutory formula, will be determined in accordance with the circumstances in each case.

[6] In the *Rockford Life Insurance* case, No. 722, current term, the company occupied the whole building and claimed the right to deduct all the expenses attributable to the building although it received only $15 in rents during the taxable year (No. 722, R. 13).

The allowance of a deduction only to the extent that it relates to the income which is to be taxed and the denial of such deduction when it does not relate to such income have been held to be within the competency of Congress. *Lewis* v. *Commissioner,* 47 F. (2d) 32 (C.C.A. 3d).

Upon similar principles in *Denman* v. *Slayton,* 282 U.S. 514, this Court held that a diminution of the deduction for interest paid by excluding therefrom interest paid to buy or carry tax-exempt securities was constitutional. As the income from such securities was not included in taxable income, it was held proper not to allow as a deduction the interest paid in order to earn such income.

Also, in the Revenue Act of 1924 Congress adopted the suggestion of the Secretary of the Treasury in his Annual Report for the fiscal year 1922,[7] and amended the provisions limiting the tax on capital gains so as to provide, as an equalizing measure, that the deduction for capital losses should be similarly limited. Section 208 (c), Revenue Act of 1924 (U.S.C., Title 26, Sec. 939). In *Otto Keusch* v. *Commissioner,* 23 B.T.A. 216, it was contended that this provision was unconstitutional, but the section was held to be valid. The Circuit Court of Appeals for the Third Circuit dismissed a petition for review (60 F. (2d) 481), and this Court denied certiorari, 287 U.S. 641.

This process of correlating deductions to the particular income taxed has been applied to state

[7] 2 Holmes, *Federal Taxes* (6th Ed.), p. 728, footnote 68.

income taxes as well. In *Shaffer* v. *Carter*, 252 U.S. 37, it was held that an Oklahoma income tax statute, which in the case of nonresidents reached only their income within the State, might properly disallow as a deduction losses incurred outside the State.

We believe that the determination of the validity of the provision in question does not require consideration of the power of Congress to tax the rental value of property as income.[8] When Section 245 (b) is considered in the light of all of the special provisions for the taxation of life insurance companies, it is clear that it was not the purpose of Congress to tax the rental value of space occupied by the owner. Consideration of such rental value in the return, where the taxpayer elects to obtain the benefit of deductions applicable to the whole building, is merely a convenient method of reducing the amount of a deduction. See dissenting opinion of Judge Tuttle (R. 54–55). It has been held repeatedly that the validity of a tax does not turn upon the yardstick by which it is measured.

Either the Federal or a State government may constitutionally impose an excise tax on corporations for the privilege of doing business in corporate form, and measure the tax by the property or net income of the corporation, including tax-exempt securities or income derived there-

[8] It may be observed that the Supreme Court of Wisconsin has held that the estimated rental value of property occupied by the owner may properly be treated as income for state income tax purposes. *Income Tax Cases*, 148 Wis. 456.

from. *Provident Institution* v. *Massachusetts*, 6 Wall. 611; *Society for Savings* v. *Coite*, 6 Wall. 594; *Hamilton Co.* v. *Massachusetts*, 6 Wall. 632; *Home Ins. Co.* v. *New York*, 134 U.S. 594; *Flint* v. *Stone Tracy Co.*, 220 U.S. 107. Receipts from exports may properly be included in computing a Federal tax (*Peck & Co.* v. *Lowe*, 247 U.S. 165; *Barclay & Co.* v. *Edwards*, 267 U.S. 442), and the measure of a State tax may include receipts from interstate commerce (*U.S. Glue Co.* v. *Oak Creek*, 247 U.S. 321; *Shaffer* v. *Carter*, 252 U.S. 37; *Underwood Typewriter Co.* v. *Chamberlain*, 254 U.S. 113).

Upon like principles we think that Congress may constitutionally require a taxpayer to include in gross income the rental value of space occupied by it as a condition to receipt of the privilege of deductions, irrespective of whether it could, under other circumstances, treat the value of such space as taxable income, since it is clear that the process under the present statute is but a means to a lawful end.

This case is unlike *Miller* v. *Milwaukee*, 272 U.S. 713, where there was an attempt to measure the tax by exempt income while excluding from its measure all taxable income. Cf. *Pacific Co.* v. *Johnson*, 285 U.S. 480. In *Miller* v. *Milwaukee*, *supra*, this Court said (p. 715):

> A tax very well may be upheld as against any casual effect it may have upon the bonds of the United States when passed with a different intent and not aimed at them, but

> it becomes a more serious attack upon their immunity when they are its obvious aim.

It is obvious that the provision challenged here was not aimed at the taxation of rental value as such.

Since it is clear that Congress has plenary power to deal with deductions, the challenge of the statute in this case seems to resolve itself into an attack upon the form in which an admitted power was exercised.

Assuming that the end in view otherwise justified the means adopted by Congress, this Court has no concern, of course, with the question whether the means adopted were the wisest or the best calculated to effect the desired result. *Block* v. *Hirsh*, 256 U.S. 135, 158. The power of Congress to limit deductions for interest was challenged in *Flint* v. *Stone Tracy Co., supra*, but this Court held that the tax was not invalid and said (pp. 173–174):

> This provision may have been inserted with a view to prevent corporations from issuing a large amount of bonds in excess of the paid-up capital stock, and thereby distributing profits so as to avoid the tax. In any event, we see no reason why this method of ascertaining the deductions allowed should invalidate the act. Such details are not wholly arbitrary, and were deemed essential to practical operation. Courts cannot substitute their judgment for that of the legislature. In such matters a wide range of discretion is allowed.

The court below relied upon a supposed analogy between this case and *National Life Ins. Co.* v. *United States*, 277 U.S. 508, but in our view that case is distinguishable upon the ground later pointed out in *Denman* v. *Slayton*, 282 U.S. 514. In the *National Life Ins. Co.* case the question was whether Section 245 (a) (2) of the Revenue Act of 1921 could be given effect against the taxpayer to reduce its deduction for reserves by the amount of interest received on tax-exempt securities. The Court said of the effect of the provision involved (p. 519):

> If permitted, this would destroy the guaranteed exemption.

And again (p. 522):

> Congress had no power purposely and directly to tax state obligations by refusing to their owners deductions allowed to others.

In *Denman* v. *Slayton*, *supra*, it was held that the provision denying the right to deduct from gross income interest paid to purchase or carry tax-exempt securities violated no guaranteed exemption because it did not require the taxpayer to pay more upon his taxable receipts than was demanded of others solely because he was in receipt of interest from tax-free securities, and the *National Life Ins. Co.* case was distinguished on that ground. We submit that the instant case may be distinguished on similar principles. The distinction made here is not between taxpayers earn-

ing exempt income and others earning taxable income. The distinction is between taxpayers who claim allowances for the expenses of producing taxable income only, and taxpayers who seek to reduce taxable income by the expenses of producing income which is not taxed. We submit that the thing really taxed in this case is the income from interest, dividends, and rents less the allowances permitted by the statute, and that the limitation of the allowance by a formula designed to exclude the expenses of producing nontaxable income is not invalid.

In *Evans* v. *Gore*, 253 U.S. 245, and *Miles* v. *Graham*, 268 U.S. 501, also relied upon by the court below, the point was that not only were the judges required to return their exempt compensation as gross income, but they were taxed upon this amount as upon other salaries or income received. There was no compensating deduction in those cases. Surely it would not have been contended that, had the salary been included in the gross income and then provision been made for a compensating deduction of a larger amount, there could have been any occasion for complaint on the theory that the exempt salary was taxed as such.

This is not shown to be a case where the taxpayer is required to pay a larger tax than would be due if it did not occupy its own building. It is clear that if it had rented to others the space occupied

by it its rental income would have been increased accordingly. It is probable, too, that if the space occupied by it had remained vacant the expenses of maintaining the building would have been less than reported. All of these factors enter into the computation of the tax, and it has not been shown that the challenged provision places any burden upon the taxpayer from which others similarly situated are free. Of course, it is not necessary that the statute shall secure exact equality among taxpayers, for this Court has pointed out in *Metropolis Theatre Co.* v. *Chicago,* 228 U.S. 61, 69–70, that "The problems of government are practical ones and may justify, if they do not require, rough accommodations—illogical, it may be, and unscientific."

Section 245 (b) had another purpose, in addition to that of correlating expenses with the limited class of income to be taxed. Section 245 (a) (2) provides for the deduction from gross income of 4 percent of the mean of the reserves at the beginning and end of the taxable year. The object of that provision was to exclude from taxable income that portion of the interest, dividends, and rents received which must be "used each year in maintaining the reserve, *i.e.,* adding to it on the basis of a certain interest rate, varying from 3 per cent to 4 per cent according to the requirements of the statutes of the several States." *National Life Ins. Co.* v. *United States,* 277 U.S. 508, *supra;* p. 525

(dissenting opinion).[9] But the reserve funds of life-insurance companies are commonly invested in home-office property as well as in securities. See Hearings, *infra,* p. 47. To the extent, therefore, that the home-office building is occupied by the underwriting departments of the company, the assets held in reserve contribute nothing to the maintenance of the reserve, and the allowance of a deduction of 4 percent in respect of the reserves represented by the building is illogical and out of place. Thus in the instant case, if it is proper to assume, as we think it is, that the home-office property constituted a part of the respondent's assets held as a reserve against policy obligations, we find the situation to be that the respondent receives a deduction of 4 percent on account of the building although the building gives a net return of considerably less than 4 percent. Moreover, this is in addition to the deduction allowed, under the decision below, on account of the expense of maintaining that part of the building which produces no investment income. The Hearings (*infra,* p. 47) show that those who drafted Section 245 (b) had this situation in mind, and that one purpose of that section was to correct the distortion resulting from the allowance of the 4 percent reserve deduction in circumstances such as are present here.

[9] The statutory rate in Tennessee, the State in which the respondent was incorporated, is 4 percent. Laws of Tennessee, 1895, ch. 160, sec. 8. (Shannon, Annotated Code of Tennessee (1917) Sec. 3288).

There is a further reason for concluding that the tax involved is not invalid. This Court has pointed out that the Federal income tax acts cover taxes of different classes, and that in some of their aspects the taxes laid are excise taxes. *Willcuts* v. *Bunn,* 282 U.S. 216, 227. It is obvious that the tax upon life insurance companies is not the usual income tax upon the entire net income. It is a tax upon only a selected portion of the income. The insurance companies do not account for premium receipts or capital gains, but only for income from investments, and the deductions are not those designed to arrive at net income in the ordinary sense. The tax thus imposed may, we submit, be regarded as being in substance, if not in form, a special excise tax. It was so considered in the dissenting opinion of Mr. Justice Brandeis in *National Life Ins. Co.* v. *United States,* 277 U.S. 508, *supra,* p. 522, and was not expressly characterized otherwise in the majority opinion.

If the tax in respect of life insurance companies were designated an excise tax, imposed on the privilege of doing business, we submit it would not be invalid because measured in part by the rental value of property used in the conduct of the business. The power of Congress to include in the measure of an excise things which could not be taxed directly is well settled. See *Pacific Co.* v. *Johnson,* 285 U.S. 480; *Educational Films Corp.* v. *Ward,* 282 U.S. 379; *Blodgett* v. *Silberman,* 277 U.S. 1; *Greiner* v. *Lewellyn,* 258 U.S. 384; *Flint* v. *Stone*

Tracy Co., 220 U.S. 107. Moreover, an excise need not be apportioned, but need only be geographically uniform. *Flint* v. *Stone Tracy Co., supra; Bromley* v. *McCaughn*, 280 U.S. 124; *Patton* v. *Brady*, 184 U.S. 608, 622.

Proper application of the presumption of the validity of legislation requires that regard be had for the substance of the thing accomplished and that its form should not control. In substance the statute levies no tax on real estate, since in any case in which the deductions are claimed they will exceed the rental value of the space occupied by the taxpayer; otherwise the taxpayer would not elect to take them, knowing the condition upon which they are granted. We submit that the purpose and effect of the Act are merely to limit allowable deductions, that the means adopted have a reasonable relation to the end in view, and that no attempt is being made to levy a direct tax which is invalid for want of apportionment.

As heretofore pointed out, the sole attack upon the tax has been upon the ground that it is a direct tax, and no claim has been made that the statute is invalid under the Fifth Amendment. While we believe that the statute is not open to attack upon that ground, it is apparent that the present case does not admit of consideration of any such question.

Since the question was not raised, the record has not been prepared to meet a contention that the

tax is arbitrary or capricious. It cannot be assumed, as was done by the court below (R. 51), that the difference between the rental values for the two years was due solely to the application of an arbitrary formula. A change in any one of the factors used in computing the rental value would produce a different result. The record clearly shows that in 1924 the expenses increased over 1923 by nearly $16,000, while the rents received from others were $2,300 less in 1924 than in 1923. The only factors which remained constant were taxes and depreciation. Neither can it be assumed that the 1923 figure for rental value is normal, nor that the 1924 figure is excessive. For all this record shows, the figure for 1923 may be less than the actual rental value and the figure for 1924 may be its substantial equivalent. It is to be observed, also, that the gross return on the book value of the building, aside from the value of the space occupied by the respondent, was more than 16 percent in 1923 and slightly less in 1924, and that in spite of this large return the expenses in 1923 nearly equaled the actual gross receipts and in 1924 exceeded them.

In view of the peculiar nature of the tax upon insurance companies, it is obvious that the question whether the requirement that there be included in gross income the rental value of space occupied by the owner in an amount sufficient to provide a net return of 4 percent of the book value of the building, is arbitrary and capricious in its practical operation would require consideration of many

factors, none of which are before the Court in this case. Among others, the factors to be considered would seem to be the extent of the deduction for reserves and the value to be placed upon the space occupied by the owner, apportioned between the space used for producing taxable investment income and that used in the production of nontaxable underwriting income. This would require a consideration of many elements in the taxpayer's business and a complete analysis of the investment and underwriting income and the methods by which it was earned. If computation of the rental value of space occupied by the owner resulted in a different figure in two or more different years, analysis of any changes in expenses, book value, and rentals paid by others would seem to be necessary in order to determine whether a change in the actual rental value of the taxpayer's space had occurred and whether any of the elements which enter into the computation of rental value under the statute ought, because of the peculiar circumstances of the particular case, to be given a new or special weight in the computation.

Thus, even if the question had been raised by the respondent, we believe that it would be quite impossible, upon the meager facts before this Court, to determine whether, as applied to this taxpayer, the statute was arbitrary or capricious. Decision of constitutional questions cannot be made in the absence of facts disclosing the reason for the enactment and the effects of its operation. See *O'Gor-*

man & Young, Inc., v. *Hartf'd Ins. Co.*, 282 U.S. 251; *Insurance Co.* v. *Glidden Co.*, 284 U.S. 151, 158; *Boston & Maine R. Co.* v. *Armburg*, 285 U.S. 234. Accordingly, we believe that the record should be considered as limiting consideration of constitutional objections to the contention of the respondent in the Board of Tax Appeals that the statute imposes a direct tax which is invalid for want of apportionment.

II

THE STATUTE ALLOWS THE DEDUCTIONS UPON A CONDITION: RESPONDENT WILL NOT BE HEARD TO RELY UPON THE GRANT OF THE ALLOWANCES AND AT THE SAME TIME TO ASSAIL THE CONDITION

If the statute is construed, contrary to our contention, as being expressly laid upon the rental value of the space occupied by the respondent in its own building, nevertheless we submit that the respondent should not be permitted to recover. The respondent invited the application of Section 245 (b) by claiming the deductions, and this case therefore suggests the application of the well-settled rule that one who voluntarily accepts the privileges and benefits of a statute will not be permitted to repudiate the burdens attached by it to the privilege claimed. This Court recently declared, in *Frost* v. *Corporation Commission*, 278 U.S. 515, 527:

> It is not open to question that one who has acquired rights of property necessarily based upon a statute may not attack that

statute as unconstitutional, for he cannot both assail it and rely upon it in the same proceeding.

The same principle has found application in numerous circumstances. Thus, it has been held that one cannot invoke the aid of a statute conferring jurisdiction and at the same time attack the validity of the statute so invoked. See *United Gas Co.* v. *R. R. Commission,* 278 U.S. 300, 307–308; *Wall* v. *Parrott Silver & Copper Co.,* 244 U.S. 407; *Electric Co.* v. *Dow,* 166 U.S. 489; *Great Falls Mfg. Co.* v. *Attorney General,* 124 U.S. 581, 598–599. Similarly, a property owner who has availed himself of the benefits arising from street or sewer improvements may not sue to cancel his tax bill on the ground that the manner of apportioning the cost of the improvements violated his rights under the Fourteenth Amendment. See *St. Louis Co.* v. *Prendergast Co.,* 260 U.S. 469. See also *Wight* v. *Davidson,* 181 U.S. 371. In *Booth Fisheries* v. *Industrial Commission,* 271 U.S. 208, an employer who had elected to be bound by a workmen's compensation act and who had accepted the benefits and immunities conferred by that act was held to be precluded from questioning its constitutionality on the ground that it deprived him of the right of full judicial review.

It is well established that corporations may not, in general, challenge the validity of provisions imposed upon them by a State as a condition of their

incorporation. See *Pierce Oil Co.* v. *Phoenix Rfg. Co.*, 259 U.S. 125; *International & G. N. Ry. Co.* v. *Anderson Co.*, 246 U.S. 424; *Interstate Railway Co.* v. *Massachusetts*, 207 U.S. 79; *Grand Rapids & Indiana Ry Co.* v. *Osborn*, 193 U.S. 17; *Hancock Mutual Life Ins. Co.* v. *Warren*, 181 U.S. 73; *Waters-Pierce Oil Co.* v. *Texas*, 177 U.S. 28; *Horn Silver Mining Co.* v. *New York*, 143 U.S. 305. See also *Railway Express Co.* v. *Virginia*, 282 U.S. 440. Likewise, acceptance of a franchise has been held to bar a subsequent contention that the grant from the State entailed an unconstitutional burden in addition to the privilege sought and obtained. See *Fox River Co.* v. *R. R. Commission*, 274 U.S. 651, 657; *Southern Utilities Co.* v. *Palatka*, 268 U.S. 232; *Columbus Ry. & Power Co.* v. *Columbus*, 249 U.S. 399.

The allowance of deductions from taxable income, like the grants of privileges or immunities or extensions of benefits involved in the cases cited above, is a matter of legislative sufferance or permission. A reasonable condition attached to the allowance should not be open to question by one who has claimed the deduction allowed.

In the case at bar it is complained that the statute requires the taxpayer to include the rental value of the space occupied by it in its own building as income, which is alleged to result in an unconstitutional tax. But the provision of which complaint is made is applicable to the company only because it has itself taken the benefits of the

deductions upon which the operation of the challenged provision depends. If the deduction had not been made, the provision would by its own terms have been inapplicable. That a very real benefit has been obtained by the company's election to invoke the statute is apparent from consideration of the facts appearing in the record. Under the statute the taxpayer has obtained total deductions of $70,005.18 for 1923 and $85,918.97 for 1924 (R. 18). The present suit involves a tax upon only $14,784.70 for 1923 (R. 18), and upon $34,400.08 for 1924 (R. 19). The benefits secured, it is apparent, are substantial. It is clear that the consideration moving from the taxpayer to obtain them is not a disproportionate one; and, since it is unquestioned that to withhold any deduction whatsoever was wholly within the competence of Congress, it cannot be maintained that the consideration was exacted under duress.

We submit that the court below erred in saying that the respondent "accepted no benefits under Section 245 (b) of either act" (R. 52). Subdivision (b) qualifies subdivisions (a) (6) and (a) (7), extending to the taxpayer the privilege of taking the deductions there specified (in respect of home office property) only upon the condition stated. When read together, as they must be, these provisions have precisely the same meaning as if home office property had been expressly excluded from (a) (6) and (a) (7) and separate provisions had been made for such property in subdivi-

sion (b). It would then have been abundantly clear that the privilege and the condition were so inseparable that the taxpayer could not have the benefit of the one without assuming the burden of the other. But the legislative purpose is so apparent that the form of the act should not, we submit, inhibit its fulfillment.

Frost v. *Corporation Commission*, 278 U.S. 515, *supra*, is not opposed to our contention as the court below held (R. 52). The appellant there was challenging the validity of a proviso which had been added some years after the enactment of the statute. The Court held that the rule of estoppel did not apply because the proviso was separable from the provisions which it qualified, having been enacted later, and consequently the appellant could claim rights under the original Act without regard to the invalid amendment. Here all the provisions were enacted at the same time and formed part of a harmonious whole. The rights of the respondent do not owe their existence solely to Section 245 (a) (6) and (7), for the privilege there granted was expressly qualified and limited by Section 245 (b). Those paragraphs together constitute the statutory provisions relative to the deduction of expenses having to do with real estate. Accordingly, the *Frost* case is not in point, and we submit that the circumstances here are such as to preclude the respondent from rejecting one part of the section while relying on another part.

In any event, the interdependence of these provisions would seem to call for a readjustment of the respondent's tax liability, because subdivisions (a) (6) and (7) of Section 245, insofar as they relate to home-office property, cannot stand if subdivision (b) is held invalid. While the Act contains the usual saving clause (Section 1403), that does no more than create a presumption that "eliminating invalid parts, the legislature would have been satisfied with what remained." *Champlin Refining Co.* v. *Corporation Commission,* 286 U.S. 210, 235. This presumption may be overcome by "considerations that make evident the inseparability of the provisions or the clear probability that the legislature would not have been satisfied with the statute unless it had included the invalid part." *Utah Power & Light Co.* v. *Pfost,* 286 U.S. 165, 184–185. We submit that such clear probability exists here. If the Court should strike down subdivision (b) but still hold the respondent entitled to the deductions claimed, the taxable investment income would obviously be distorted. Without the limitation expressed in that subdivision the deductions for real estate expenses, insofar as they include home-office property, are entirely inappropriate and out of line with the plan of taxation, and it is extremely improbable that Congress would have granted any deductions at all in respect of such property had it been advised that the limitation was invalid.

The distortion of taxable income which would result from the separation of these provisions is strikingly illustrated by *Rockford Life Ins. Co.* v. *Commissioner,* No. 722. The taxpayer there occupied the entire building, returning only $15 rental income therefrom. Nevertheless, it claims deductions for taxes, depreciation, and repairs, aggregating ~~$3,003.05~~ $83-05. (No. 722, R. 13.)

CONCLUSION

We submit that the provision requiring insurance companies to report the rental value of space occupied by them does not impose a direct tax and that the selection of this method of limiting deductions is not open to question.

In any event, we submit that the taxpayer, having received the benefits conferred by Section 245 (a) (6) and (7), should not be permitted to repudiate the condition upon which those benefits were granted.

For these reasons, the decision of the Circuit Court of Appeals should be reversed.

Respectfully submitted.

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MARCH 1934.

APPENDIX A

Revenue Act of 1921, c. 136, 42 Stat. 227, 261, 262:

SEC. 243. That in lieu of the taxes imposed by sections 230 and 1000 and by Title III, there shall be levied, collected, and paid for the calendar year 1921 and for each taxable year thereafter upon the net income of every life insurance company a tax as follows:

(1) In the case of a domestic life insurance company, the same percentage of its net income as is imposed upon other corporations by section 230;

* * * * *

SEC. 244. (a) That in the case of a life insurance company the term "gross income" means the gross amount of income received during the taxable year from interest, dividends, and rents.

* * * * *

SEC. 245. (a) That in the case of a life insurance company the term "net income" means the gross income less—

* * * * *

(2) An amount equal to the excess, if any, over the deduction specified in paragraph (1) of this subdivision, of 4 per centum of the mean of the reserve funds required by law and held at the beginning and end of the taxable year, plus (in case of life insurance companies issuing policies covering life, health, and accident insurance combined in one policy issued on the weekly premium

payment plan, continuing for life and not subject to cancellation) 4 per centum of the mean of such reserve funds (not required by law) held at the beginning and end of the taxable year, as the Commissioner finds to be necessary for the protection of the holders of such policies only;

* * * * *

(6) Taxes and other expenses paid during the taxable year exclusively upon or with respect to the real estate owned by the company, not including taxes assessed against local benefits of a kind tending to increase the value of the property assessed, and not including any amount paid out for new buildings, or for permanent improvements or betterments made to increase the value of any property. The deduction allowed by this paragraph shall be allowed in the case of taxes imposed upon a shareholder or member of a company upon his interest as shareholder or member, which are paid by the company without reimbursement from the shareholder or member, but in such cases no deduction shall be allowed the shareholder or member for the amount of such taxes;

(7) A reasonable allowance for the exhaustion, wear and tear of property, including a reasonable allowance for obsolescence. In the case of property acquired before March 1, 1913, this deduction shall be computed upon the basis of its fair market price or value as of March 1, 1913;

* * * * *

(b) No deduction shall be made under paragraphs (6) and (7) of subdivision (a) on account of any real estate owned and occupied in whole or in part by a life insurance company unless there is included in the

return of gross income the rental value of the space so occupied. Such rental value shall be not less than a sum which in addition to any rents received from other tenants shall provide a net income (after deducting taxes, depreciation, and all other expenses) at the rate of 4 per centum per annum of the book value at the end of the taxable year of the real estate so owned or occupied.

Revenue Act of 1924, c. 234, 43 Stat. 253, 289:

[Sections 243 (U.S.C., Title 26, Sec. 1001), 244 (U.S.C., Title 26, Sec. 1003), and 245 (U.S.C., Title 26, Sec. 1004) contain provisions substantially the same as those of the corresponding sections above quoted.]

Treasury Regulations 62:

ART. 686. *Home office properties.*—No deduction shall be made for any taxes, expenses, or depreciation on account of any real estate owned and occupied in whole or in part by a life insurance company unless there is included in the return of gross income the rental value of the space so occupied. Such rental value shall not be less than a sum which in addition to any rents received from other tenants shall provide a net income (after deducting taxes, depreciation, and other expenses) at the rate of 4 percent per annum of the book value at the end of the taxable year of the real estate so owned and occupied. For example, if the book value of a parcel of real estate owned and occupied in whole or in part by the company is $1,000,000, the rents received from other tenants $30,000, taxes and expenses $40,000, and depreciation $20,000, the company would have to include in its gross in-

come a sum not less than $70,000 ($40,000 taxes and expenses, plus $20,000 depreciation, minus $30,000 rents from tenants, plus 4 percent of $1,000,000) as the rental value of the space occupied by it in order to avail itself of the deductions of $40,000 and $20,000. In any case the rents received from other tenants must be included in gross income.

Treasury Regulations 65:

[Article 686 is substantially the same as the corresponding article set forth above.]

APPENDIX B

Extracts from hearings before Committee on Finance on H.R. 8245, 67th Cong., 1st Sess., pp. 83–84, 88, 91–93:

Doctor ADAMS. Mr. Chairman, we left off at page 93, section 242.

Gentlemen, the scheme in general in section 242 is this: It is to apply a tax on life insurance companies to make it applicable to investment income. Under the present law the premiums paid by a life insurance policyholder are deemed to be actual income by the life insurance company.

Senator MCCUMBER. How is that?

Doctor ADAMS. The ordinary annual premium that you pay on a life insurance policy is the basis of the income of a life insurance company, although no deduction can be made for it by the individual policyholder. It is regarded as a capital transaction to him. He makes no deduction for his life insurance premium payment, but the company when it gets it must regard it as income.

That being a starting point—and I think it is a false starting point—we have to authorize a lot of special and highly unscientific deductions, with the result that the taxation of life insurance companies is one of the faultiest parts of the income tax act. There is a continual litigation over insurance companies' taxes because of the method of taxation.

It has been suggested—and I think it is obviously sound—that the only true basis

of income of a life insurance company is its investment income—interest, dividends, and rents which it receives. The premium payments it gets are a good deal like a bank deposit. When it takes them over, it creates an obligation such as the obligation of a bank to return a deposit when it is called for. So that is omitted altogether. You start with the investment income, and certain deductions have been worked out with the result that the life insurance companies will pay very much more taxes under the proposed scheme than they did before.

At the same time, there was on the life insurance companies a special tax of 8 cents on the amount of new business written. That is in Title V. It is one of the special excise taxes. And with the adoption of this new method it was proposed, and the House indorsed the proposal, to wipe out all other taxes on insurance companies; that is to say, this 8 cents on new business and the capital stock tax, which involves special difficulties when applied to mutual insurance companies, and most of them are mutual; they have no true capital stock.

The CHAIRMAN. Doctor, did they have a hearing before the House committee?

Dr. ADAMS. They did not have a hearing, Mr. Chairman. This matter was worked out really so satisfactorily in the revenue act of 1918, when the life-insurance companies had gotten together, that they have not appeared before the committees, but have come to me and asked me if we could take this other scheme. I was personally very well satisfied with it, because if you adopt a 15 percent rate, or if the 15 percent income-tax

rate originally proposed had been adopted, we would get more under that 15 percent tax with the new scheme of taxation than under all the others combined. I am not certain that the 12½ percent rate will do that. I think it will leave us a little less than we had before. But the scheme would have been infinitely simpler, and we would have avoided this continual litigation.

Senator McCUMBER. Will you repeat again just how you propose to tax them?

Dr. ADAMS. The scheme of taxation starts by defining their gross income as investment income, namely, their incomes from dividends, rents, etc. Then there are recorded against that certain deductions, which I will read.

Senator McCUMBER. And that is satisfactory to both the mutual and the old-line companies?

Dr. ADAMS. All the life-insurance companies are behind that scheme and are satisfied with it.

* * * * *

The CHAIRMAN. I know that you are so saturated with the thing that what seems plain to you is still obscure to us. In the last bill there was nothing that we had more contention over than this insurance provision, owing to the peculiar attitude of Mr. Kitchin, and probably every insurance man in the United States of any prominence was down here to see members of the committee. It has been different this year. Not one has been to see me; so it must be satisfactory to them.

Dr. ADAMS. Senator, I shall follow and shall be only too glad to follow the suggestions made.

Senator SIMMONS. You say this is probably what we had in the Senate bill before and they come down here and had long conferences with Dr. Adams and others and they agreed to that. Now, after it has been put in by the House, as the House was the stumbling block before, I take it that they think it will meet with no trouble in the Senate because we passed it once.

* * * * *

The CHAIRMAN. Doctor, is not the allowance for obsolescence rather unusual?

Dr. ADAMS. That is checked immediately below. It would be unusual except for this purpose: Where property is held as a part of the investment of the company, and they are obviously entitled to a deduction for the obsolescence depreciation against that part of the property. Obsolescence is not special to insurance companies. We mention it in connection with depreciation allowance to other taxpayers. That is exactly the same verbiage as applies to other taxpayers.

The CHAIRMAN. It refers to property held by the insurance companies?

Dr. ADAMS. Yes; and for investment. You will see that this is limited and circumscribed in the section that I am about to read:

"(b) No deductions shall be made under paragraphs (6) and (7) of subdivision (a) on account of any real estate owned and occupied in whole or in part by an insurance company unless there is included in the return of gross income the rental value of the space so occupied. Such rental value shall be not less than a sum which in addition to any rents received from other tenants shall provide a net income (after deducting taxes, depreciation, and all other expenses) at the

rate of 4 percent per annum of the book value at the end of the taxable year of the real estate so owned or occupied."

Now, the thought there is this: Insurance companies very frequently invest a large portion of their funds in a building which they themselves occupy. That is an investment of a peculiar kind. It yields no income except as it saves them the rental expenditure. Where that is true, the companies acquiesce in this provision that they shall not have deduction for real-estate taxes, or that they shall not have deduction for depreciation unless they put the estimated investment income from that building back into their income. You see that it is a sort of a silent income. It is income only by saving them what they would have to spend if they did not put their money in that building.

Senator SIMMONS. That is where they use the building only for the purpose of carrying on another business than insurance?

Dr. ADAMS. Yes.

Senator SIMMONS. But where they rent and use a part of that building——

Dr. ADAMS. That is taken care of in this provision, because it says that you have to actually get in income 4 percent of the capital invested in that building, and unless you have that much you cannot take a deduction for taxes or a deduction for depreciation, but if you have that much you may take those deductions. And you may also take those deductions in case of real estate which you own and rent to other people.

Senator MCCUMBER. Now, tell me, Doctor, why the necessity for all that complexity? Why could not you compel the company to make a return for all income received, whether it was an investment in a building or otherwise, and then allow them to deduct

their taxes on that building, which gives them a net of what they received on the building? What is the use of that 4 percent and an addition? They have invested.

Dr. ADAMS. They may occupy, as I know one insurance company does, all the floors except the first and second and third. They occupy 11 floors. They may rent part or the whole. In getting at their occupancy, a large part of which is estimated rental value, there would be innumerable difficulties, which we would dispute and haggle about. Estimated rental value is very difficult to get at.

Senator MCCUMBER. What is the use of charging them off rent they do not pay? As long as they have their capital invested in so many floors, and they are occupying them, they do not have to pay that sum out, and consequently they receive that much more. Their gross income would be that much more, and their net income would be that much more, and you tax their net income. What is the use of dividing that into a 4 percent proposition and having all these complexities?

Dr. ADAMS. I was trying to explain that. Your solution of it was the solution that I suggested originally. It is the result of long conferences and lot of thought and care. I said to these gentlemen, "Why take your deductions for taxes on real estate which you occupy? Why put in your income from real estate which you occupy, your estimated income?" They convinced me that it would be more satisfactory to do it that way—more accurate. After our investigation I was satisfied of the correctness of their views in the case of some of these enormous New York build-

ings, like the Metropolitan Building, Twenty-third and Broadway, New York.

The CHAIRMAN. Any of those large buildings.

Dr. ADAMS. The thing does not check out. It is more accurate to go through the roundabout process of allowing them the depreciation and deduction. This estimate of rental value is a terrifically difficult thing. It is difficult for us; it is difficult for anybody to estimate what the rental value of a building is where it is not actually rented to somebody else. In order to cover that situation it is necessary to say that unless they are actually renting to somebody and by contract getting the money we will put in a limitation and assume they are receiving at least a certain amount net for it.

Every word of the phraseology of that section has been gone over by insurance experts of the very highest caliber. Only a few people are involved. The public is not interested in this. They do not have to read it, and the people who deal with it are experts. Every word of that phraseology was presented to the insurance officials, and only those companies who are involved must understand it. Of course, you gentlemen must understand it, as long as you have to pass upon and approve it. You people have an understanding that the outside public does not have to have.

Senator MCCUMBER. But suppose a company is organized to do a mercantile business, puts up its own building, invests so much of its own capital, and it occupies a certain number of stories in that building and rents the others. If they invest capital in a place to live in, a place to do business in, they do not have to pay rent. They save

that much. You compel them to make a return of what they receive for rent of a certain portion of that building?

Dr. ADAMS. Yes.

Senator MCCUMBER. Just the same as any other line of business. Why should that not apply equally to insurance companies?

Dr. ADAMS. The reason for that is that you have a situation with insurance companies which does not apply to any other companies. A great part of their business is nontaxable. They put up a building costing fifteen or twenty million dollars. Nineteen twentieths of it may be used for the transaction of the nontaxable part of their business. There is where that difficulty has arisen. Nineteen twentieths of it may be used for the purpose of collecting premiums and paying losses, to which we are now paying no attention. That is the nontaxable end of their business. Perhaps only one half of one floor is given to the investment business, which is the taxable end of their business.

They would come along and say they had a certain depreciation deduction on certain taxes they paid. We would have to go through some kind of prorating process to say how much depreciation there should be and how it would be taxable, as assigned to the taxable or investment end of their business. To avoid that this plan is used. You cannot base deduction on all the taxes; you cannot base depreciation on all the taxes without some limitation, because we must get some generally just and equitable method of prorating those deductions.

Senator SIMMONS. I do not know that I understand this question; and I will state to you my understanding of it, and ask you if I am correct.

This means they shall not be entitled to the deductions provided in paragraphs 6 and 7 where they occupy a part of the building, unless they include in their gross income return the value of the space so occupied. Now, in order to fix the value of that space, you take the rents they receive from other tenants, and you add to that a sum which will make an annual return for that property of 4 percent.

Dr. ADAMS. Four percent. There is another purpose there that is very essential, and that is this: You are giving these companies a deduction of 4 percent on their reserve fund. Their reserve funds are invested in this building. You are giving them a deduction of 4 percent once, through the 4 percent reduction against reserve funds. You do not want to give them that again. You take the rent which they get and deduct the depreciation from it, and the remainder should not be less than 4 percent upon the capital invested.

Senator SMOOT. Suppose it is more than 4 percent?

Dr. ADAMS. All right; if it is more than 4 percent, we are willing to do it, but it will not be less than that, because they have already had that deduction.

Senator SMOOT. If it is more, we would want the difference over and above it.

Senator SIMMONS. Four percent is a very small return upon real estate.

Senator SMOOT. I do not think so.

Senator SIMMONS. You do not?

Senator SMOOT. I do not think there is any real estate in the United States, with all expenses and depreciation paid, which will net 4 percent.

* * * * *

U. S. GOVERNMENT PRINTING OFFICE: 1934

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JAN 23 1934
CHARLES ELMORE CROPLEY
CLERK

IN THE

Supreme Court of the United States

October Term 1933—No. 689.

GUY T. HELVERING, Commissioner of Internal Revenue, - - - - - - - - - - Petitioner,

versus

THE INDEPENDENT LIFE INSURANCE COMPANY.

On Petition for a Writ of Certiorari to the United States Circuit Court of Appeals for the Sixth Circuit.

SUGGESTION OF THE INDEPENDENT LIFE INSURANCE COMPANY REGARDING ISSUANCE OF THE WRIT.

JAMES A. NEWMAN,
General Counsel,
WM. MARSHALL BULLITT,
Special Counsel.

WESTERFIELD-BONTE COMPANY, INCORPORATED, LOUISVILLE, KY.

IN THE

Supreme Court of the United States

October Term 1933—No. 689.

GUY T. HELVERING, COMMISSIONER OF INTERNAL REVENUE, - - - - - - - - - *Petitioner,*

v.

THE INDEPENDENT LIFE INSURANCE COMPANY.

On Petition for a Writ of Certiorari to the United States Circuit Court of Appeals for the Sixth Circuit.

SUGGESTION OF THE INDEPENDENT LIFE INSURANCE COMPANY REGARDING ISSUANCE OF THE WRIT.

To the Honorable, the Chief Justice and the Associate Justices of the Supreme Court of the United States:

The Independent Life Insurance Company *agrees* with the Government's contentions:

(1) That there is a direct conflict between the decision of the C. C. A. (6th) in this case, and that of the C. C. A. (7th) in *Commissioner* v. *Lafayette Life Ins. Co.*, 67 F. (2d) 209, and *Commissioner* v. *Rockford Life Ins. Co.*, 67 F. (2d) 213;

(2) That the C. C. A. (6th) has held a section of the Federal Revenue Law applicable to life insurance companies to be unconstitutional;

(3) That in view of the wide applicability of the section in question to many life insurance companies, and of the conflict between the decisions in 6th and 7th Circuits, such conflict should be settled by this Court.

If this Court shall deem it proper to issue a writ of *certiorari* in this case, The Independent Life Insurance Company interposes no objection thereto.

If such writ of *certiorari* is issued, then it is believed that this Court should also issue a writ of *certiorari* in the companion case from the 7th Circuit, wherein the Rockford Life Insurance Company is now petitioning for a writ of *certiorari* to review such conflicting decision in the 7th Circuit.

JAMES A. NEWMAN,
General Counsel,
WM. MARSHALL BULLITT,
Special Counsel.

January 12, 1934.

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CHARLES ELMORE CROPLEY
CLERK

IN THE

Supreme Court of the United States,

OCTOBER TERM, 1933.

GUY T. HELVERING, COMMISSIONER, ETC. — *Petitioner,*

vs. No. 689

INDEPENDENT LIFE INSURANCE CO.,

On writ of Certiorari to the United States Circuit Court of Appeals for the Sixth Circuit.

ROCKFORD LIFE INSURANCE CO., — *Petitioner,*

vs. No. 722

GUY T. HELVERING, COMMISSIONER, ETC.,

On writ of Certiorari to the United States Circuit Court of Appeals for the Seventh Circuit.

BRIEF FOR THE INSURANCE COMPANIES.

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The Evening Post Job Printing Office, Inc., 154 Fulton St., New York, N. Y.

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THIRD POINT:

The government's theory,

(a) that the Revenue Act allowed deductions (6) (7), solely upon condition that the insurance company would consent to a tax upon the "rental value" of the real estate which it occupied; and, (consequently)

(b) that having taken deductions (6) (7), the insurance company is estopped from contesting the constitutionality of the "direct" tax upon the "rental value,"

is untenable, because Congress cannot impose an "unconstitutional condition", to wit, that a person shall surrender or waive a constitutional right as the price of receiving some benefit allowed to others. 47–56

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Rockford Life Ins. Co. R. 15; 27 B. T. A. 1419; *Com'r* v. *Rockford Life Ins. Co.* 67 F. (2d) 213: R. 23.

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STATUTES INVOLVED. Revenue Act of 1921 §§245, 42 Stat. 227, 261; Revenue Act of 1924, §245, 43 Stat. 253, 289; Revenue Act of 1928, §203, 45 Stat. 791, 842.

DATE OF JUDGMENT, etc. No. 689. *Independent Life* case, Nov. 10, 1933 (R. 48).

No. 722. *Rockford Life* case, Oct. 20, 1933 (R. 24).

NATURE OF THE CASES, RULINGS, ETC. Commissioner of Internal Revenue determined certain deficiencies in income tax for 1923 and 1924 against the Independent Life Ins. Co., and for 1929 against the Rockford Life Ins. Co.

1. The B. T. A. held that § 245(b) of the Revenue Acts of 1921 and 1924, and §203(b) of the Revenue Act of 1928 were unconstitutional, as attempting to levy a "direct" tax (without apportionment) on the "rental value" of real estate occupied by the owner itself.

2. The B. T. A. further held in No. 722 that the Rockford Life was entitled to a deduction of $1,783.02 for depreciation of its furniture and fixtures; and that it was not limited to a deduction of only $292.56 for depreciation upon only such furniture and fixtures as were *used exclusively* in what the Commissioner called the *Investment* department of its business.

3. The C. C. A. (6th) affirmed the B. T. A. in No. 689, *Independent Life* case; and the C. C. A. (7th) reversed the B. T. A. in No. 722, *Rockford Life* case.

4. Certiorari was granted in each case.

IN THE

SUPREME COURT OF THE UNITED STATES

OCTOBER TERM, 1933

GUY T. HELVERING, Commissioner, etc., *Petitioner*

vs. No. 689

INDEPENDENT LIFE INSURANCE CO.

ROCKFORD LIFE INSURANCE CO., *Petitioner*

vs. No. 722

GUY T. HELVERING, Commissioner, etc.

On writs of Certiorari to the United States Circuit Courts of Appeals for the Sixth and Seventh Circuits.

BRIEF FOR THE INSURANCE COMPANIES.

The facts are all stipulated. There is no controversy about any fact.

The purely legal questions involved in both cases are:*

(1) Is the *"rental value"* of real estate (when *occupied* by its *owner*) "income" which can be taxed under the 16th Amendment without apportionment? Or would it be a "direct" tax on the owner's real estate itself?

(2) Whatever the rule might be as to the *fair* or *actual* "rental value", can Congress fix an *arbitrary* figure which does not even purport to approximate the true

* All page references in this Brief are to the Record in No. 689, *Independent Life* Case, unless otherwise expressly indicated.

"rental value" of the occupied space, and then declare it to be "income", subject to income taxation?

(3) If, for either reason (1) or (2), such "rental value" is *not* subject to income taxation, can an *owner* of real estate who *occupies* it for his own use, be required to include such alleged arbitrary "rental value" in his income tax return, as the price of obtaining the same deductions for taxes, expenses and depreciation, as all similar real estate owners receive, who *do not occupy* their own real estate?

B. T. A. decision.

The B. T. A. decided, *First*, that any such tax on the "rental value" of an owner's realty was a "direct" tax (R. 25-29); *Second*, that Congress could not require a real estate owner to include in his gross income, the "rental value" of the property which he did not rent to others, but occupied for his own use, as a condition of the deduction of taxes, expenses and depreciation (R. 29-31); and, *Third*, that the particular "rental value" determined by the rule prescribed by Congress, did not constitute "income" under the 16th Amendment (R. 31-33).

C. C. A. decisions.

The C. C. A. (6th) *affirmed* the B. T. A. on the last ground, towit, that the particular "rental value" prescribed by Congress for inclusion *as* "income", was *not* income within the 16th Amendment as interpreted by this Court (*Com'r* v. *Independent Life*, 67 Fed. (2d) 470; R. 51, 52).

The C. C. A. (7th), without the citation of authority, or any discussion of the nature of the tax, *reversed* the

B. T. A., and held that Congress could lawfully prescribe, as a condition of allowing deductions (taxes, expenses and depreciation), that the "owner-occupier" must include such "rental value" as a part of his income (*Com'r* v. *Lafayette Life Ins. Co.*, 67 F. (2d) 209, 212; No. 722, *Rockford Life* case (R. 23-24; 67 F. (2d) 213).

Additional Question in Rockford Life Case.

The following additional question arising under § 203(a)(7) of the Revenue Act of 1928 is involved in the *Rockford Life* case only, *i. e.*

(4) Is a life insurance company entitled to deduct depreciation on *all* its "furniture and fixtures" or is the deductible depreciation limited to *such part* of its "furniture and fixtures" as it uses in what the Commissioner styles the *"Investment"* part of its business? The B. T. A. decided for the Rockford Life (No. 722, R. 15; 27 B. T. A. 1419).

The C. C. A. (7th) *reversed* the B. T. A. (No. 722, R. 23; 67 F. (2d) 213).

Relevant Statutes.*

[Revenue Act of 1921, 42 Stat. 227, 261; Revenue Act of 1924, 43 Stat. 253, 289; Revenue Act of 1928, 45 Stat. 791, 842. Our Italics.]

Sec. 244(a) That in the case of a life insurance company the term *"gross income"* means the gross amount of income **received during the taxable year** from *interest, dividends and rents.* * * *

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* No. 722, *Rockford Life* case, involves § 203 of the Revenue Act of 1928, 45 Stat. 791, 842, but it is so nearly identical with § 245, *supra*, that it need not be set out here.

Sec. 245(a) That in the case of a life insurance company the term *"net income"* means the gross income *less*—

(1) [Tax-exempt Interest]

(2) [4% of Reserve]

(3) [Certain dividends]

(4) [Deferred dividends]

(5) [Investment Expenses]

(6) Taxes and other expenses paid during the taxable year exclusively upon or with respect to the real estate owned by the company. * * *

(7) A reasonable allowance for the exhaustion, wear and tear of property, including a reasonable allowance for obsolescence. * * * *.

(8) [Interest paid on indebtedness]

(9) [$2,000 exemption]

(b) No deduction shall be made under paragraphs (6) and (7) of subdivision (a) on account of any real estate *owned and occupied* in whole or in part by a life insurance company unless there is included in the return of gross income the *rental value* of the space so occupied. Such rental value shall be not less than a sum which in addition to any rents received from other tenants shall provide a net income (after deducting taxes, depreciation, and all other expenses) at the rate of 4 per centum per annum of the book value at the end of the taxable year of the real estate so owned or occupied.

STATEMENT OF THE CASE.

1. *Independent Life's Home Office Building.* The Independent Life owned a 12-story Home Office Building with a "book value" of $460,000 for 1923, and of $494,257.97 for 1924; occupied *one* floor for its own business, and *rented out* all the remaining *eleven* floors for which it could secure tenants (R. 16).

For 1923 and 1924, it reported as income the entire rentals "received during the taxable year" from all its

tenants; and [under § 245(a) (1-8)] deducted taxes, expenses and depreciation as follows, omitting cents (R. 38-40):

	1923		1924	
GROSS INCOME [under § 244(a)]				
Interest	$19,704		$20,519	
Dividends	0		0	
Rents	73,620	$93,325	71,289	$91,809
DEDUCTIONS [under § 245(a)]				
(1) Interest	$1,948		$1,687	
(2) 4% Reserve	20,363		22,773	
(5) Investment Exp.	1,946		2,220	
(6) (7) R. E. taxes, etc.	70,005*		85,918*	
(8) Interest	8,552	$102,815	868	$113,509
NET INCOME	[*Deficit*]	$9,492	[*Deficit*]	$21,760

As the Company *deducted* $70,005 and $85,918 respectively constituting items (6) and (7) as *authorized* by § 245(a)(6), (7), the Commissioner held that the Company must, therefore, as *required* by § 245(b), *include* in its Gross Income, *not only* the $73,620 and $71,289 *rentals actually "received* during the taxable year" from all tenants (which sums it had already included in its returns of income), but the *further arbitrary sums* of $14,784 for 1923 and $34,400 for 1924 (presumed to constitute the "rental value" of the *one floor occupied* by the Company); which further arbitrary sums when added to the $73,620 and $71,289 *actual* rentals "received during the taxable year", would produce the *equally arbitrary sums* of $88,405 and $105,689 respectively as the ideal "rental value" for the entire building, so as to constitute (after deducting *actual* expenses and depreciation) a 4%

1923		1924	
*(6) Taxes	$11,147	(6) Taxes	$11,147
R. E. Expenses	51,357	R. E. Expenses	67,271
(7) Depreciation	7,500	(7) Depreciation	7,500
	$70,005		$85,918

net return on the Building's "book value", thereby fictitiously converting the foregoing *actual deficits* into small *fictitious net incomes*, to wit (omitting cents; R. 39, 40):

	1923		1924	
INCOME				
Interest		$19,704		$20,519
Actual Rentals	$73,620		$71,289	
*"Rental Value" of one floor	14,784	88,405	34,400	105,689
Alleged *Gross* Income		$108,109		$126,209
DEDUCTIONS [as before]		102,815		113,569
Alleged *Net* taxable income		$5,294		$12,739

which alleged net income (after $2,000 exemption and a trifling previous assessment), resulted in the small deficiency-taxes here in controversy, of $298.97 for 1923 and

* The Commissioner's hypothetical calculations were arrived at as follows, omitting cents (R 6-8):

First. The "book value" of the Home Office Building was $460,000 for 1923 and $494,257 for 1924. The Revenue Act required the building *as a whole* (*after* deductions for taxes, expenses and depreciation) to return, as net rental, 4% of the "book value," *i. e.*, $18,400 for 1923 and $19,770 for 1924 [§ 245(b)].

Second.	1923		1924	
Rents (actual)	$73,620		$71,289	
Expenses	70,005		85,918	
Net Income (actual)	$3,615		$14,629	[*Deficit*]
"Rental value" of one floor occupied by Independent Life	14,784	$14,784	34,400	$34,400
4% on "book value"	$18,400		$19,770	
Rents (actual)		73,620		71,289
Forced to be reported as income "received" from rents		$88,405		$105,689

Although for 1923 there was an actual net rent income of only $3,615, yet by requiring the Home Office one-floor space occupied by the company to be valued at $14,784, the *actual* $3,615 net "rent income" **was forced to be stated at $18,400.**

For 1924, [by valuing the Home Office one-floor space at

$1,115.65 for 1924—a total alleged deficiency of $1,414.62 (R. 3, 5, 16, 49).

2. *Rockford Life's Home Office Building.* The Rockford Life owned and occupied for its own use its entire Home Office Building with a book value of $77,524.21 (No. 722; R. 13). For 1929, the following $4,033.05 deductions taken on account of its Home Office Building under §203(6)(7) of the Revenue Act of 1928, were *disallowed* by the Commissioner (No. 722; R. 3-4, 10, 13).

Taxes	$1,808.03
Repairs	411.31
Depreciation	1,813.71
	$4,033.05

The Commissioner *disallowed* those $4,033.05 deductions simply because the Rockford Life had *failed* [as required by § 203(b)] *to include* in its gross income $7,134.02 as the "rental value"* of its Home Office Building wholly occupied by itself in its insurance business (No. 722; R. 7).

The Rockford Life was thus denied the right to deduct its $4,033.05 taxes, etc., solely because it would not submit to the inclusion in its Gross Income of $7,134.02* purely

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$34,400 or nearly *two and a half* times as much as for 1923], a $14,629 actual *deficit*, **was forced to be stated as a net rent income of $19,770.**

The Revenue Act's method thus made the so-called "rental value" of the one-floor, $14,784 for 1923, and nearly *two and a half times* as much for 1924, *i. e.*, $34,400. Thus, for two successive years, with no change in tax rate and with no change in conditions shown (except a small increase in "book value"), a real estate owner was required to pay, with respect to the same floor he occupied himself, an income tax of *more than twice as much* for one year (1924) as for the previous year (1923).

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* Computed as follows by § 203(b) Revenue Act of 1928:

Hypothetical "Rental Value"	$7,134.02
Expenses	4,033.05
Required result: 4% on $77,254.21 "book value" =	$3,100.97

hypothetical income,—none of which was actually received—but which was declared by the Revenue Act to be the conclusively presumed "rental value" of the space occupied by itself in its *own* building.

[For convenience, the simple facts as to the Rockford Life's "furniture and fixture" controversy will be stated in connection with the Argument on that point, p. 57, *infra*.]

3. *Explanation of method of income taxation of life insurance companies.* From 1913 to 1920, life insurance companies were taxed upon their *net income;* all premiums paid in by policyholders were included as "*gross* income"; but, on account of the nature of life insurance, Congress allowed certain large *special* deductions summarized in the margin.* (*Maryland Casualty Co. v. U. S.*, 251 U. S. 342, 346-8; Brandeis, *J.* (dissent) in *National Life Ins. Co. v. U. S.*, 277 U. S. 508, 522, 523).

The Revenue Acts of 1913, 1916, 1917, and 1918, thus recognized that, as *all premiums were included as income*, the large *special* deductions noted in the margin must be allowed, in order to exclude that which the companies (1) paid out to policyholders, or (2) were compelled to retain as legal "Reserve" to meet future death losses as they should occur. This was so, on exactly the same theory

* The special deductions so allowed (1913-1920) were, to wit: (1) the net addition required by law to be made within the taxable year to Reserve funds; (2) sums other than dividends paid within the taxable year on policy and annuity contracts; and (3) in the 1918 Revenue Act, such portion of any actual premium received from any individual policyholder as is paid back or credited to, or treated as, an abatement of premium of such policyholder within the taxable year (Act Oct. 3, 1913, Section II G(b), 38 Stat. 172-3; Revenue Act of 1916, § 12(a), 39 Stat. 767-8; Revenue Act of 1917, 40 Stat. 302-305; Revenue Act of 1918, §§ 233(a)(1), 234(a)10, 40 Stat. 1077, 1079; Compare Act August 5, 1909, § 38, 36 Stat. 113).

that if a State (or Congress) includes in a bank's income or taxable assets *all the money deposited in the bank by its depositors during the year,* it must either (*a*) make the tax infinitesimally small or (*b*) allow as a deduction all the checks drawn by depositors during the year, plus the amount owing to depositors at the end of the year.* In the *National Life* case Solicitor General MITCHELL expressly so conceded, aptly saying that premiums

"*are no more income to the company* than are *deposits* in a bank *income to the bank*" (Government's Brief, p. 12). Otherwise, both the banking and insurance businesses would be taxed out of existence.

That erroneous treatment (1913-1920) of premium receipts, with corresponding special deductions, had been productive of administrative difficulties and some litigation (*McCoach* v. *Insurance Co. of N. Amer.*, 244 U. S. 585; *Maryland Cas. Co.* v. *U. S.*, 251 U. S. 342; *U. S.* v. *Boston Ins. Co.*, 269 U. S. 197; *New York Life Ins. Co.* v. *Edwards*, 271 U. S. 109; *Duffy* v. *Mutual Benefit Co.*, 272 U. S. 613; BRANDEIS, *J.*, in *National Life* case, 277 U. S. at 523).

Revenue Act of 1921.

The 1921 Revenue Act (1) simplified the taxation of life companies, and (2) deprived them of any benefit from holding tax-exempt bonds [(2) was declared unconstitutional in *National Life* v. *U. S.*, 277 U. S. 508]. This

* Cf. *Deposit Bank of Owensboro* v. *Daviess County*, 102 Ky. 174 at 214; *Com.* v. *Bank of Commerce*, 118 Ky. 547, 551-556; *Com.* v. *Wathen*, 126 Ky. 573, 574; *Branch* v. *Town of Marengo*, 43 Ia. 600; *People* v. *Peck*, 157 N. Y. 51; *In re Haight*, 32 App. Div. 496; *State* v. *Carson Savings Bank*, 17 Nev. 146; *State* v. *American*, 37 N. J. Law, 408; *Petition of Savings Bank*, 68 N. H. 384; *Berry* v. *Windham*, 59 N. H. 288; *Clement Nat. Bank* v. *Vermont*, 231 U. S. 120.

new 1921 method had been first suggested for the 1918 Revenue Act but failed of adoption.*

This new method of 1921 eliminated premiums from "gross income". It then defined "gross income" to include *only* such income as was "received during the taxable year" from "interest, dividends and rents" [§ 244(a)].

On the other hand, this new method eliminated from the allowable deductions many items that *other* corporations were permitted to deduct [Cf. §§ 234(a), 245(a)]. Instead of the former special deductions noted in the margin (page 8, *supra*), the 1921 Act allowed *only nine deductions* specifically itemized in nine separate numbered paragraphs of § 245(a), numbered from (1) to (9) inclusive, to-wit: (1) tax-exempt interest, (2) 4% of Reserve,† (3) dividends, (4) certain deferred dividends, (5) investment expenses, (6) real estate taxes and expenses, (7) depreciation, (8) interest paid out and (9) $2,000 specific exemption.

Item (6), real estate taxes and expenses, and Item (7) depreciation, are the only deductions involved in the present cases.

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* Cf. §§ 246(a)(1)(2), 247, of Senate Amendment 186 to Revenue Act of 1918 (Senate Report No. 617, 65th Cong. 3d Sess. H. R. 12863); §§ 244(a), 245(a)(1)(2) Revenue Act of 1921, 42 Stat. 261. Cf. Brandeis, *J.*, in *National Life* case, 277 U. S. at 523, note.

† The reason for allowing Item (2) as a deduction, *i. e.* 4% of Reserve, was that the "interest, dividends and rents" received, were used, in part, each year to maintain the legal Reserve. Consequently, when Congress allowed a deduction of 4% on the Reserve, it was not an arbitrary favor, as the Government repeatedly assumes in its Brief, but it was an *economic necessity*, so long as there was any pretense of "income" taxation; though, constitutionally, of course, Congress might have refused any deduction, and taxed the business into insolvency.*

* Some courts hold that the Reserve belongs to the company and may be taxed (*In re Oklahoma*, 173 Pac. 376, 13 A. L. R. 174; *Com. Life* v. *Kentucky*, 145 Ky. 284, 36 L. R. A. (N. S.) 226); while other courts hold that the Reserve is a debt (*Alabama Gold Life Ins. Co.* v. *Lott*, 54 Ala. 499; *Insurance Co.* v. *Board of Equalization*, 74 Iowa 178; *Insurance Co.* v. *Detroit*, 133 Mich. 408).

SUMMARY OF POINTS DISCUSSED.

1. Taxation of the "rental value" of the two Home Office Buildings, to the extent that they were occupied by their owners, was a "direct" tax on the land itself, levied solely because of ownership; and such a tax is void unless apportioned (pp. 12-38, infra).

2. The taxation of the "rental value" of property when occupied by the owner, was not a mere "correlation of deductions with the limited class of income to be taxed" (as the Government contends) but it was the levy of a "direct" tax upon real estate because the owner occupied it (pp. 39-47, infra).

3. The Government's theory,

(*a*) *That the Revenue Act allowed deductions* (*6*) and (7), *solely upon condition that the insurance company would consent to a tax upon the "rental value" of the real estate which it occupied; and, consequently,*

(*b*) *That having taken deductions* (*6*) *and* (*7*), *the insurance company is estopped from contesting the constitutionality of the "direct" tax upon the "rental value".*

is untenable, because Congress cannot impose an "unconstitutional condition" to wit, that a person shall surrender or waive a constitutional right as the price of receiving some benefit allowed to others (pp. 47-56, infra).

4. The Rockford Life was entitled to a deduction of $1,783.02 for depreciation on all its furniture and fixtures.

It should not be limited to an allowance of only $292.56 upon the small quantity of furniture and fixtures used exclusively in what the Commissioner calls the "Investment" Department of its business (pp. 57-69, infra).

FIRST POINT.

Taxation of the "rental value" of the two Home Office Buildings, to the extent that they were occupied by their owners, was a "direct" tax on the land itself, levied solely because of ownership; and such a tax is void unless apportioned.

1. The Independent Life actually "received during the taxable year" only $73,620 in 1923 and $71,289 in 1924 as rents from all the tenants in its building; it returned those sums as income and was duly taxed thereon (No. 689; R. 5-8):

The Rockford Life did not receive any* rent income whatever from its building.

All rents that the two insurance Companies derived from their real estate were "income" and subject to "income" taxation; were included in their returns; and were duly taxed—as to which they make no complaint whatever.

2. Nevertheless, the Commissioner determined a deficiency-tax against both Companies, by calculating a further 12½% income tax upon the "rental value" of the space occupied by them in their respective office buildings, which were *wholly owned* by them (No. 689; R. 5-8, 16; No. 722; R. 5-8, 13).

To the extent that the Commissioner seeks to impose such *further* "income" tax upon a supposed "rental value" of the space which the owner occupied in his own real estate, *solely by virtue of his ownership thereof*, we insist that the Commissioner is in error—because such a tax is not a tax on "income" (for there was *no* such income);

* Except $15 which was included in its income tax return and properly taxed (No. 722; R. 13).

but it is a "direct" tax on the land itself *imposed solely because of ownership*, which can only be levied by the rule of apportionment.

3. The Revenue Acts now in controversy seek, for the first time in constitutional history, to tax (without apportionment), not the rents actually "received during the taxable year," but an arbitrarily *assumed* "rental value" of land when *occupied by the owner;* and only then when the "owner" *happens* to be a life insurance company.

From the foundation of this Government it has been universally recognized by Congress, and held by this Court, that a tax levied upon dwelling houses, buildings, land or other real estate *because of the ownership thereof* was a "direct" tax that must be apportioned.*

We submit:

I. *The tax on the "rental value" of the Independent Life's 1-floor and of the Rockford Life's entire building, solely because occupied by them as the respective owners thereof, is a "direct" tax on the land itself, imposed solely because of its ownership; and the tax thereon is void for want of apportionment.*

If a Federal tax can be levied (without apportionment) upon the "rental value" of real estate—which is not in

* *Hylton* v. *U. S.*, 3 Dall. 171, 175, 176, 183; *Veazie Bank* v. *Fenno*, 8 Wall. 533, 544; *Scholey* v. *Rew*, 23 Wall. 331, 346-7; *Springer* v. *U. S.*, 102 U. S. 586, 596, 598, 602; *Pollock* v. *Farmers Loan & Trust Co.*, 157 U. S. 429, 581, 583, 621; *Id.* 158 U. S. 601, 627; *Knowlton* v. *Moore*, 178 U. S. 41, 81; *Flint* v. *Stone Tracy Co.*, 220 U. S. 107, 150; *Brushaber* v. *Union Pacific*, 240 U. S. 1, 15, 19; *Stanton* v. *Baltic Mining Co.*, 240 U. S. 103, 114; *Eisner* v. *Macomber*, 252 U. S. 189, 205-6, 217; *Bromley* v. *McCaughn*, 280 U. S. 124, 136, 139.

Compare the "direct" apportioned taxes under Act July 14, 1798, 1 Stat. 597; *Id.* 580; Acts August 2, 1813 and July 22, 1813, 3 Stat. 164, 166; Act August 5, 1861, 12 Stat. 292, 294, as reviewed in the *Pollock case*, 157 U. S. at pp. 572-3; *Veazie Bank* v. *Fenno*, 8 Wall. 533, 542; and *Springer* v. *U. S.*, 102 U. S. 586, 598.

fact rented and from which no rentals are derived—so that a corporation may be subjected to a so-called "income" taxation upon the "rental value" of its own land when occupied by itself, then the following constitutional consequences to individuals necessarily ensue:

(1) The grocer, small shopkeeper, or physician who owns his own home and lives in its second story or in the back room of a cottage,—while his grocery, shop or doctor's office occupies the ground floor or front room of the cottage,—may also be subjected to "income" taxation on the "rental value" of the space so occupied by him in his business.

(2) Every owner of unimproved real estate or of vacant buildings, can be similarly taxed, *i. e.*, the owner of a *vacant* city lot, residence or office building or of unrented farm land, can be required to pay an "income" tax on some statutory measure of its "rental value"—although the property is actually vacant, uncultivated, and no revenue or income has been derived therefrom.

(3) The farmer who leaves a field idle (either to "rest" the ground or to reduce production under some recovery program); every dairyman who lets his cows go dry (to avoid a surplus of milk and to raise the price); and every landlord with empty tenements on his hands, can, each and all, be made to pay an "income" tax (including, perhaps, heavy surtaxes) on the imaginary "rental value" of his land or cows, which he has not in fact rented or hired out, and from which he has derived no income whatsoever.

But that is not all.

(4) Every individual owner of his own home can be required to pay an "income" tax on a similar imaginary

"rental value" of the space therein which he occupies with his family as his residence.

Those are illuminating illustrations of the reasons why this Court has so repeatedly emphasized that any tax levied in respect of real estate, *because of its ownership,* is a direct tax which must be apportioned (See note below).

[I.] A tax upon the "rental value" of land when occupied by the owner, is plainly a "direct" tax on the land itself, *imposed solely because of its ownership* [See authorities collated in the margin].

If an insurance company *rents* a building to use as its Home Office, but does not occupy all the space, the Revenue Act *does not tax* the company on the "rental value" of (*a*) the space it occupies or, (*b*) the vacant space which it does *not* occupy; and this is so solely because the company *does not own* the building.†

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* In *Knowlton* v. *Moore,* 178 U. S. 41, 81, referring to certain language in the *Pollock* opinion, Mr. Justice WHITE said that such language

> "was but a statement that a tax which was in itself direct, *because imposed upon property solely by reason of its ownership,* could not be changed by affixing to it the qualification of excise or duty."

Flint v. *Stone Tracy Co.,* 220 U. S. 107, quoted with approval that language from *Knowlton* v. *Moore,* and added (p. 150):

> "The act now under consideration does not impose direct taxation upon property *solely because of its ownership* * * * The *Pollock* case construed the tax there levied as direct, because it was imposed upon property *simply because of its ownership.*"

In *Brushaber* v. *Union Pacific,* 240 U. S. 1, 15, Chief Justice WHITE said that the Civil War income taxes were classed as excises, because

> "they were not taxes directly on property *because of its ownership.*" [Footnote continued on next page.]

† If an insurance company *owns* a building but *does not occupy any* space in it, then the Revenue Act taxes it *only* upon the rents actually collected from other tenants; and does not attempt to tax it for any alleged "rental value" of vacant space.

But, on the other hand, if an insurance company *owns* its Home Office building, and occupies any portion thereof (whether one room or several floors) the Revenue Act taxes it on the "rental value" of *all* the space it so occupies, and this tax is imposed *solely* because the company *owns* the building.

The Government may argue that the tax is not levied *solely* because of ownership, but because of (1) ownership, plus (2), *occupancy* of the thing owned. That is simply an argument that the owner of land or of personal property may be taxed (without apportionment) *for*

He also said, page 19:

> "* * * It is to be observed that, although from the date of the *Hylton Case* because of statements made in the opinions in that case it had come to be accepted that direct taxes in the constitutional sense were confined to taxes levied directly on real estate *because of its ownership*, the Amendment contains nothing repudiating or challenging the ruling in the *Pollock Case* that the word direct had a broader significance since it embraced also taxes levied directly on personal property *because of its ownership* * * *."

Eisner v. *Macomber*, 252 U. S. 189, 205, said that the *Pollock* case held taxes upon rents of real estate

> "were in effect direct taxes upon the property from which such income arose, *imposed by reason of ownership.*"

The Court said that of course Congress had power to tax shareholders upon their property interests, but added (p. 217):

> "But this would be taxation of property *because of ownership*, and hence would require apportionment under the provisions of the Constitution, is settled beyond peradventure by previous decisions of this Court."

In *Bromley* v. *McCaughn*, 280 U. S. 124, 136, it was said,

> "While taxes levied upon or collected from persons *because of their general ownership of property* may be taken to be direct, *Pollock* v. *Farmers Loan & Trust Co.*, * * *"

In his dissenting opinion in *Bromley* v. *McCaughn*, SUTHERLAND, *J.*, said (p. 139):

> "to levy a tax by reason of *ownership of property* is to tax the property, *Dawson* v. *Kentucky Distilleries Co.*, 255 U. S. 288, 294."

the privilege of occupying or possessing that which he owns; and that such a tax is not a "direct" tax on the thing owned, but is an *"excise"* tax for the *privilege* of occupying or possessing the thing owned.

If that argument is sustained, then the constitutional guaranty against "direct" taxes without apportionment, has been absolutely frittered away.

The very essence of ownership is the right to the possession (*i. e.,* the occupancy) of the thing owned.

In *Dawson* v. *Kentucky Distilleries Co.,* 255 U. S. 288, a Kentucky statute imposed a so-called "license" tax of 50¢ a gallon on distillers or warehousemen with respect to all whiskey withdrawn from bond or shipped in bond to a point outside the State. This Court decided that it was a "property" tax because the thing really taxed was the owner's *right to possession* of his own property; and that "to tax the right is to tax the value," saying by Mr. Justice BRANDEIS (p. 294);

> "But as stated by the lower court, 'the thing really taxed is the act of the owner in taking his property out of storage into his own possession (absolute or qualified) for the purpose of making some one of the only uses of which it is capable, *i. e.,* consumption, sale or keeping for future consumption or sale. . . . The whole value of the whisky depends upon the owner's right to get it from the place where the law has compelled him to put it, and to tax the right is to tax the value. To levy a tax by reason of ownership of property is to tax the property. Compare *Thompson* v. *Kreutzer,* 112 Miss. 165; *Thompson* v. *McLeod,* 112 Miss. 383."

As there, so here. A tax on the "rental value" of land does not have a single incident of a license, privilege, or occupation, unless it be the *privilege of ownership.* But to tax the privilege of *ownership,* is, according to the

holding of this Court in many cases (pp. 15, 16, note; *supra*) the very essence of "direct" taxation on the property itself.

The Revenue Acts now in controversy seek to tax the supposed "rental value" of land, only when *occupied* by the owner. What is that but a "direct" tax on the land itself?

Suppose Congress levied a $10 tax on every *owner* of real estate (regardless of the extent or value of the real estate owned); would it not be a "direct" tax on land, imposed solely by reason of the *ownership* thereof. Again, if the tax were 10% of the value of the land, it would equally be a "direct" tax.

Suppose Congress imposed a $25 tax on every owner of a residence for the *privilege* of owning the land or of *residing* therein; would not that be a "direct" tax on the land, imposed solely because of its ownership?

Would the nature of the tax be changed, if, instead of relating to residential property, it were $25 on every *owner* of a business house for the privilege of owning the house *and occupying it?* Or again, would the nature of the tax be changed, if, instead of being $25 flat, it were 5% of the assessed value of the land? Or if it were 12½% of the "rental value" which the owner *might* have collected as rents had he chosen to rent it out, instead of occupying it for his own purposes?

Congress can tax any lands owned, but it can only do so subject to the rule of apportionment. If the guaranty against a "direct" tax (without apportionment) can be avoided by a so-called *"excise"* tax for the privilege of *owning,* or for the privilege of possessing or *occupying* the land owned, the guaranty is nullified.

Suppose Congress levied a tax, which it termed an "excise" tax, upon each *landowner* for the privilege of possessing and occupying his land, the amount of such "excise" tax to be 5% of the value of the land owned. Such a tax would certainly be a "direct" tax on the land, or the English language has lost its meaning.

So here, a tax upon the "rental value" of the space which an insurance company occupies in the building which it owns, is just as "direct" a tax on the land as can well be imagined.

It cannot possibly be defended as an "excise" tax on the owner of the land for the *privilege* of owning or occupying the land which he owns. It is nothing more or less than a *"direct"* tax upon the land, *imposed because of its ownership.* The constitutional guaranty against taxation of land without apportionment, ceases to amount to anything, if, when the owner *occupies* that which he owns, he automatically loses the protection of the guaranty.

This Court has always held that a tax on land is a "direct" tax. If, then, this Court shall now decide that it is an "excise" tax, for Congress to tax a land-owner a percentage of (*a*) the market value of the real estate or (*b*) an annual "rental value", simply for the privilege of the land-owner occupying his own land, then the constitutional guaranty against direct taxation disappears, and nothing whatever is left of that fundamental guaranty. This is so, because, if it is constitutional to tax, without apportionment,—12½% of the assessed value of land, or alternatively 12½% of what the land might be rented for,—for the privilege of the owner occupying his farm, his cottage or his office building, then the door is open for Congress, without apportionment, to levy on land

any taxes that it pleases, absolutely without restraint or limitation, by the simple device of declaring that the tax so levied in respect of the land (whether a percentage of land value or a percentage of assumed annual rental value), is merely for the *privilege of owning, or occupying* the land so owned.*

If this Court shall now decide that it is *not* a tax on land, to make the owner pay in taxes a percentage of its possible rental value (when it is not in fact rented but merely *owned*), what becomes of the constitutional guaranty against the direct taxation of land without apportionment?

[II.] A tax on rents from real estate is still a "direct" tax on the land itself,—although the 16th Amendment has removed the necessity of apportionment in levying a tax on such rents.†

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* The historical matter submitted at the hearing of the *Pollock Case,* the two opinions of Chief Justice FULLER therein, and the repeated opinions of this Court before and after the *Pollock Case,* demonstrate that the framers of the Constitution well understood the distinction between "direct" and "indirect" taxation; that taxes on, or in respect of, the ownership of land were known to be *direct* taxes; that there was a great struggle over the grant of power to Congress to levy "direct" taxes; that the rule of apportionment was the compromise by which the adoption of the Constitution was secured; and that when the States surrendered certain great sources of revenue, they retained that of direct taxation, and limited its concurrent grant to Congress, so that Congress could not levy a tax on land except by apportionment.

† *Pollock case,* 157 U. S. at 583; 158 U. S. at 637; *Knowlton* v. *Moore,* 178 U. S. 41, 81; *Flint* v. *Stone Tracy Co.,* 220 U. S. 107, 148-50; *Brushaber* v. *Union Pacific,* 240 U. S. 1, 16-19; *Peck & Co.* v. *Lowe,* 247 U. S. 165, 172; *Eisner* v. *Macomber,* 252 U. S. 189, 205-6; *Bowers* v. *Kerbaugh-Empire Co.,* 271 U. S. 170, 174.

If a tax on rents *actually collected* is a "direct" tax on the land, *a fortiori,* a tax on the "rental value" of the land when occupied by the owner and *not* rented out, *and not collected,* is an even more *direct* tax on the land itself.

[Whether such *uncollected* "rental value" is "income" within the meaning of the 16th Amendment so that the tax thereon is relieved of apportionment, will now be considered, pp. 21-26, *infra.*]

II. *The "rental value" of land when occupied by its owner, does not constitute "income" to the owner within the meaning of the term "income" as used in the 16th Amendment.*

The Government may possibly contend that the "rental value" of space occupied by the owner of a building, is something which is of *benefit* to the owner, because unquestionably the owner derives a benefit from the space which he occupies, whether as a residence, shop, doctor's office or insurance quarters. Such a benefit is not "income" in the sense used in the 16th Amendment, but it is merely the benefit which *automatically flows from ownership.*

The Government's Brief apparently concedes that a tax on "rental value" is a "direct" tax on the land which must be apportioned (Government's Brief, pp. 8, 17); at least it does not make any argument to the contrary.*

* In response to the Government's suggestion (Brief, p. 17, *note*) that the Wisconsin *Income Tax Cases,* 148 Wis. 456, held that *"estimated rental value* of property occupied by the owner may be properly treated *as income* for State income tax purposes", we reply that the question here is not whether it is "income" in the *State* sense, but (1) whether a tax on "rental value" is a *"direct"* tax on land and (2) whether "rental value" is *"income"* in the sense of the 16th Amendment as defined by *this* Court.

In *Eisner* v. *Macomber*, 252 U. S. 189, 206, the Court said:

> "In order, therefore, that the clauses cited from Article I of the Constitution may have proper force and effect, save only as modified by the Amendment, and that the latter also may have proper effect, it becomes essential to distinguish between what is and what is not 'income,' as the term is there used; and to apply the distinction, as cases arise, according to truth and substance, without regard to form. Congress cannot by any definition it may adopt conclude the matter, since it cannot by legislation alter the Constitution, from which alone it derives its power to legislate, and within whose limitations alone that power can be lawfully exercised.
>
> "The fundamental relation of 'capital' to 'income' has been much discussed by economists, the former being likened to the tree or the land, the latter to the fruit or the crop; the former depicted as a reservoir supplied from springs, the latter as the outlet stream, to be measured by its flow during a period of time. For the present purpose we require only a clear definition of the term 'income' as used in common speech, in order to determine its meaning in the Amendment; and, having formed also a correct judgment as to the nature of a stock dividend, we shall find it easy to decide the matter at issue.
>
> "After examining dictionaries in common use (Bouv. L. D.; Standard Dict.; Webster's Internat. Dict.; Century Dict.), we find little to add to the succinct definition adopted in two cases arising under the Corporation Tax Act of 1909 (*Stratton's Independence* v. *Howbert*, 231 U. S. 399, 415; *Doyle* v. *Mitchell Bros. Co.*, 247 U. S. 179, 185)—'Income may be defined as the gain derived from capital, from labor, or from both combined,' provided it be understood to include profit gained through a sale or conversion of capital assets, to which it was applied in the *Doyle Case* (pp. 183; 185).
>
> "Brief as it is, it indicates the characteristic and distinguishing attribute of income essential for a correct solution of the present controversy. The Government, although basing its argument upon the definition as quoted, placed

chief emphasis upon the word 'gain,' which was extended to include a variety of meanings; while the significance of the next three words was either overlooked or misconceived. *'Derived—from—capital';—'the gain—derived—from—capital,'* etc. Here we have the essential matter; *not* a gain *accruing to* capital, not a *growth* or *increment* of value *in* the investment; but a gain, a profit, something of exchangeable value *proceeding from* the property, *severed from* the capital however invested or employed, and *coming in,* being *'derived,'* that is *received* or *drawn by* the recipient (the taxpayer) for his *separate* use, benefit and disposal;—*that* is income derived from property. Nothing else answers the description."

In *Bowers* v. *Kerbaugh-Empire Co.*, 271 U. S. 170, 174, this Court said:

"'Income' has been taken to mean the same thing as used in the Corporation Excise Tax Act of 1909, in the Sixteenth Amendment and in the various revenue acts subsequently passed. *Southern Pacific Co.* v. *Lowe,* 247 U. S. 330, 335; *Merchants L. & T. Co.* v. *Smietanka,* 255 U. S. 509, 519. After full consideration, this Court declared that income may be defined as gain derived from capital, from labor, or from both combined, including profit gained through sale or conversion of capital. *Stratton's Independence* v. *Howbert,* 231 U. S. 399, 415; *Doyle* v. *Mitchell Brothers Co.,* 247 U. S. 179, 185; *Eisner* v. *Macomber,* 252 U. S. 189, 207. And that definition has been adhered to and applied repeatedly. See e. g. *Merchants L. & T. Co.* v. *Smietanka, supra,* 518; *Goodrich* v. *Edwards,* 255 U. S. 527, 535; *United States* v. *Phellis,* 257 U. S. 156, 169; *Miles* v. *Safe Deposit Co.,* 259 U. S. 247, 252-253; *United States* v. *Supplee-Biddle Co.,* 265 U. S. 189, 194; *Irwin* v. *Gavit,* 268 U. S. 161, 167; *Edwards* v. *Cuba Railroad,* 268 U. S. 628, 633."

The benefit of occupying or using one's own property is much further removed from "income" than the stock dividends held in *Eisner* v. *Macomber* not to constitute "income" within the meaning of the 16th Amendment

Since a *growth*, or *increment of value*, to property is not "income" to the owner, surely mere occupancy of the property by the owner himself cannot be considered "income."

The B. T. A.'s full consideration of the subject and review of the authorities should be carefully read, from which we quote briefly as follows (No. 689; R. 27-29):

> "Thus the only theory upon which a tax on the *rental value* of real estate occupied by the owner could be laid without apportionment, would be that such rental value is income within the legal signification of that term as used in the Sixteenth Amendment.
>
> That it may be sometime regarded as income by economists some of whom may use the term as applying to benefits or enjoyments is not controlling, *Lynch* v. *Turrish*, 247 U. S. 221; *Merchants Loan & Trust Co.* v. *Smietanka*, 255 U. S. 509. Nor may we look to the use and meaning of the word income found in statutes of several of the States, for the same constitutional requirements do not exist to give force to the limitations of definition.
>
> Here the restriction upon Congress is that it may not use or define the term so as to bring about an unapportioned direct tax, and no authority can be attached to usage free from a similar restriction. The English usage to exclude profits from capital sales were disregarded in *Merchants Loan & Trust Co.* v. *Smietanka, supra;* and the Massachusetts usage to include stock dividends was disregarded in *Eisner* v. *Macomber, supra.* In the 1894 act, which was the precursor of the Sixteenth Amendment, rents were included, but no reference was made to *rental value*, and, as we have seen, the *Pollock* case took as a postulate that the use and value of realty was the realty itself rather than the income therefrom. The Corporation Excise Tax Act of 1909 used income in the same sense as a measure of excise tax, *Flint* v. *Stone, Tracy Co.*, 220 U. S. 107.
>
> Therefore there is nothing in the history immediately preceding the Sixteenth Amendment to give support to a

more expansive use of the word income than that considered in the *Pollock* case. **And clearly nothing can be said for treating rents—which indubitably are income—as including rental value of space owned and occupied.** Rent has since feudal times implied two separate persons and estates, those of landlord and tenant, and it would be a misnomer to apply it to the value of a landlord's use and occupancy of his own property. Thompson on Real Property; Tiffany on Real Property; 36 *Corpus Juris* 285, See also *Duffy* v. *Central R. R.* 268 U. S. 55.

It seems to us furthermore that a construction of income to include rental value of occupancy of realty by its owner would be to narrow the force of the requirement of apportionment to a point of practical nullification. * * *

Since, as we have seen, to tax the use or value of realty as distinguished from rents or profits is to tax the realty itself, it would result that although the requirement of apportionment would nominally remain applicable to a tax imposed *eo nomine* upon the realty itself, still a tax in the same measure upon rental value of realty occupied by the owner would escape apportionment. The speciousness of such a differentiation is obvious. * * *

[Here follows a review of nine authorities.]

While these several decisions deal with problems specifically different from the one at bar, they indicate a tacit recognition that income is more than mere use or enjoyment of one's own property in its original form. There must be some sort of consummated pecuniary gain from which the tax can be paid. We find no intimation that rental value of property occupied may be regarded as income any more now than at the time of the decision in the *Pollock* case."

The C. C. A. (6th) held that "rental value" was not "income" within the meaning of the 16th Amendment, saying (No. 689; R. 50-51; *Com'r.* v. *Independent Life*, 67 F. (2d) 470, 472):

"It might be said, with a fair show of reason, that benefit in the form of actual rental value accruing to one who

> occupies his own building is in the nature of income from rents. **But we may not adopt such conception here. We are required to follow the standard definition of income found in the Sixteenth Amendment and the interpretation thereof by the Supreme Court."**

Even TUTTLE, *J.* (C. C. A. 6th), who dissented, held that "rental value" does not constitute income, saying (R. 54-55):

> "I do not dissent on the ground that such 'rental value', however defined or computed, is taxable as income, or constitutes income * * *. Of course, even if it did actually represent rental value that would not meet the constitutional objection urged against its inclusion in, and as, income taxable under the Sixteenth Amendment, **for the obvious reason that rental value does not constitute income."**

We submit that the foregoing argument (pp. 13-26, *supra*) has established that, insofar as the Revenue Acts of 1921, 1924 and 1928 imposed a tax upon the "rental value" of the space occupied by the Independent Life and the Rockford Life in their own *wholly owned* Home Office buildings, it is a "direct" tax upon their lands and is void because levied without apportionment.

III. *The particular "rental value" which the Revenue Acts compelled the insurance companies to include as income (and to pay income taxes thereon) was an arbitrary sum having no reasonable relation to income in any constitutional sense.*

1. Regardless of whether the *fair* "rental value" of land which the owner left vacant or occupied himself, is held to be "income" to such owner, so that under the 16th Amendment it can be taxed without apportionment, still

the *particular "rental value"* prescribed by the Revenue Acts is not "income" in any possible sense.

The Revenue Act of 1932 recognized that such "rental value" was not "income" and completely altered the statutory provisions now in controversy (Cf. § 203(b) Revenue Act of 1932; Report of Senate Finance Committee No. 665, 72d Congress, 1st Session, p. 36; See full quotation in Government's Brief No. 689, at pp. 14-15, footnote).

2. The Revenue Acts, in controversy here, provide that if an insurance company occupies *any* part of its own property, it must return as income the "rental value" of the space so occupied, **which rental value so demanded, must be large enough** [after deducting taxes, expenses and depreciation, from actual rentals derived from other tenants] **to make a clear net income of 4% upon the "book value" of the entire building.**

In other words, after deducting taxes, expenses and depreciation from the actual rentals collected from all other tenants in the building, the company must also include in its income (as the rental value of the space it occupies) such further sum, as when added to the *net* rent received from the other tenants, will produce a *net* taxable rental income for the entire building of 4% upon its **"book value."**

Different companies carry their Home Office buildings on their "books" at various values and for various reasons—some high, some low, some even nominal or without any reasonable relation to *actual* value. The result is that one insurance company's "book value" of its building may bear no relation whatsoever to cost, rental

return or market value or to that of any other company's building.

All consistency in the taxation of Home Office buildings may be vitiated by the "book value" at which the particular company carries on its books. To illustrate: if the Metropolitan Life (pursuant to a conservative policy of showing only liquid assets to respond to policy demands) had charged down its $10,000,000 Home Office to a "book value" of $1.00, it could have occupied the entire building, deducted all taxes, expenses and depreciation thereon, and yet, under § 245(b), it would have been required to report as the "rental value" of its *entire* building, 4% of the "book value", which would be *only four cents.* This shows the utter arbitrariness of basing the "rental value" of space occupied, upon "book value."

To illustrate concretely; two companies, A and B, own ten-story office buildings, each having a book value of $500,000. A occupies *one floor* in its building; rents out three floors to other tenants; and has vacant six floors for which if can not find tenants. B does not occupy any space in its building; but rents it all to tenants. The taxes, expenses and depreciation are the same in each building.

	A		B
Rents from tenants.....	$20,000		$70,000
Taxes, Expenses, etc.....	60,000		60,000
	[*Deficit*] $40,000	[*Income*]	$10,000
Compulsory "Rental value" of space occupied by owner...	60,000		0
Rents forced to be reported as income	$80,000		$70,000

In other words, the Revenue Acts require A (with an *actual* deficit of $40,000) to report as the "rental value" of the *one floor* it occupies in its own building, the sum of $60,000, (and to pay income taxes thereon) which is (1) *three times as much* as A collects from all the tenants it can get from its *other nine floors* and (2) nearly as much as B collects from all the tenants in its *ten* floors.

The Revenue Acts require that every insurance company which occupies *any part* of its own building must pay a 12½% tax upon an alleged net income amounting to 4% of the book value of its entire building. No matter how much or how little space the company occupies; no matter how much or how little is occupied by other tenants; no matter how much or how little rental such other tenants may pay; and no matter how much or how little the taxes, expenses and depreciation are; the company must nevertheless, return, as the "rental value" of any space it occupies, **a sum large enough to create a minimum net rental for the entire building of 4% on its "book value".**

If the rentals from other tenants were quite large, and the taxes, expenses and depreciation were small enough, the company would not have to return any sum as the "rental value" for the space it occupied (*Atlas Life Ins. Co.*, 29 B. T. A., decided January 16, 1934, page 8).

On the other hand, if the amount received from other tenants were small or a large part of the building was vacant, the company, although occupying only one room or one floor, would have to return as the "rental value" thereof, a sum large enough to produce a net income from the building as a whole equal to 4% of its book value.

These considerations merely illustrate that the Revenue Acts, in thus defining what "income" the company shall return, do not use *any* definition of "income" which falls within the definitions prescribed by this Court in many cases, but prescribe as "income" a purely arbitrary and capricious sum, bearing no relation to reality or to any authoritative definition of "income".

To take the actual case of the Independent Life; it occupied but one floor in its twelve story building. The Commissioner held that it must return as "rental value" for that one floor $14,784 for 1923, (R. 18), and $34,400 for 1924, or nearly two and one-half times as much for the same space (R. 19). Why was this? It was because in 1923 the company realized from its tenants a net profit of $3,615, but in 1924 it had an actual operating *loss* of $14,269 (largely arising from an elevator accident)—so by the Revenue Acts' rule it had to report in 1924 as "rental value" for the same one floor space, enough *to wipe out* the entire loss, and also to bring out a hypothetical rental return for the entire building of 4% on its book value.

The B. T. A. aptly pointed out that the "rental value" which the company was required to return as "income" had no relation whatever to any constitutional definition of "income", saying (No. 689; R. 32):

> "By this [§ 245(b)], as has been seen, it is provided that no figure will be recognized as rental value of space occupied which is less than enough to bring about, with net rents received, a net income from the building of 4 percent of its book value. The mathematical operation of this provision in the case at bar has been already set forth.
>
> In 1923, it brought about a figure of $14,784.70 as the rental value of one story, to be added to $73,620.48 from tenants for eleven stories; for 1924, rental value of the

same one story was computed at $34,400.08, as compared with $71,289.21 received for the remainder.

Although the *rents* received were *diminished* from 1923 to 1924, and the *charges increased* from $70,005.18 to $85,918.87, giving an apparent indication of reduced rental value of space in the building, **the required formula forces an increased rental value of the story occupied to more than double.**

Whether this is typical of the application of the statute or unique does not appear. It is the actual situation as to this taxpayer brought about by the plain requirement of the statute, and to him it cannot be said that it is an extreme illustration.

As to 1924, it results in a tax based upon *artificial income* whereas in fact there has been a *loss*. Being unable to derive 4 per cent net income from the building, petitioner is nevertheless required to construct its tax return so that it will be taxed as if it did.

It seems clear that such a tax is not upon income, but its effect is to tax the realty itself, and what we have said as to the use of actual rental value in gross income **is more forcibly true as to such a forced minimum.** A 4 percent income from an insurance building may approximate an actual or average return (and we should perhaps assume that Congress so regarded it), but it is not true income within the Sixteenth Amendment unless it has in fact been derived from the property or capital invested. **To base the tax upon the assumption that it was in fact realized, irrespective of whether it was or not, is not the power granted by the Sixteenth Amendment; and since this is the only authority under which Congress assumed to act in title II, it must fail of its purpose and be held invalid.**

What we have said as to the use of the artificial 4 percent minimum is likewise true of the use of book value as its basis. How book value in any given case may be arrived at or what it means, is not set forth in the statute, and whether it has a meaning as to life insurance companies sanctioned by law does not appear. Regulations 62, issued under the Revenue Act of 1921, treat the

accounts of life insurance companies as uniform. But bookkeeping entries are not conclusive, *Doyle* v. *Mitchell Bros. Co., supra,* and the book value of property is not to be taken as actual value, *Virginia* v. *West Virginia,* 238 U. S. 202. Thus to take book value as the standard upon which the percentage return is to be measured is to depart from fact, and just so far to define income beyond its true bounds.

And we say this, even assuming that the particular book value represents actual cost with proper adjustments for wear and tear, etc., for if the investment has proved ill-advised the actual value may be far below cost and a 4 percent return on book value may be impossible to derive.

It is urged that the book value represents actual value where books are correctly kept. This is not necessarily true, as books may be said to be correctly kept, in a sense, when they truly state the items set forth. But cost carried forward may not be the same as present value. Despite repairs and renewals, a suitable allowance for depreciation may not have been made. It would be too much to say that there is any controlling presumption * * *.

On the other hand, in the absence of a more complete showing with respect to the physical property and its condition, the expenditures for maintenance and the extent of depreciation, it is wholly impossible to say that the book cost represented the actual value at the time to which the inquiry was addressed. Book cost, as we have said, would be a more or less doubtful criterion.' *Virginia* v. *West Virginia,* 238 U. S. 202.

Thus we are driven to the conclusion, despite the presumption to the contrary, that paragraph (b), although correctly construed and applied by respondent, invades this petitioner's constitutional rights."

The C. C. A. (6th) reached the same conclusion, saying (R. 51; *Com'r. v. Independent Life,* 67 F.(2d) 470, 473):

"Whatever might be said as to the power of Congress to require life insurance companies to include in their

gross income the actual or fair rental value of space occupied by them in their own buildings (a question not necessary here to determine) it is manifest to us that the amount required to be added to gross income under sec. 245(b), before deductions may be taken, is not income when measured by the rule in *Eisner* v. *Macomber, supra,* and *Bowers* v. *Kerbaugh-Empire Co., supra.* It does not represent actual gain. It is neither of exchangeable value nor is it severed from capital. It is not something received or drawn by the taxpayer for his separate use and disposal. It is simply an arbitrary figure, determined by a mathematical formula to which must be added rents received from other tenants and from which must be deducted taxes, depreciation and all other expenses to reach a net income of 4% per annum of the **book value** (not actual value) of the building at the end of any given taxable year.

It does not even purport to approximate the true rental value of the space occupied. It must be increased or diminished inversely, each year, to the increase or decrease of rents received. In *Burk-Waggoner Ass'n* v. *Hopkins,* 269 U. S. 110, 114, the court said: 'It is true that Congress cannot make a thing income which is not so in fact.' See, also, *Flint* v. *Stone Tracy Co.,* 220 U. S. 108, 145."

We submit that we have established that the tax imposed upon the arbitrarily determined "rental value" of the space respectively occupied by the Independent Life and the Rockford Life in their own buildings, was in reality a "direct" tax upon their real estate, without such arbitrary "rental value" bearing any reasonable relation whatsoever to income or even to benefit derived from their real estate.

IV. *The tax imposed by §§ 242-245 is an "income" tax; and it is not in any sense a "special excise" tax for the privilege of engaging in the life insurance business.*

In order to avoid the "direct tax" difficulty, the Government suggests that the tax imposed on life insurance companies by §§ 242-245, is not an "income" tax at all, but that it is a "special excise tax [which] need not be apportioned, but need only be geographically uniform" (Brief, pp. 6, 24, 25).

To that we respond:

(1) The Government unsuccessfully advanced the same argument* in *National Life Ins. Co.* v. *U. S.*, 277 U. S. 508, with respect to the same tax, imposed under exactly the same sections, involved here; and although Mr. Justice BRANDEIS (dissenting) spoke of it as "a special excise tax measured by net income", the majority of the court disagreed with his view as to the nature if the tax imposed (Cf. B. T. A.'s opinion R. 23).

The C. C. A. (6th) said that to hold the present tax to be a special excise tax (R. 52)

> "would be to deny the obvious fact. In form and substance the Internal Revenue Acts under consideration levy income taxes *and not excise taxes*".

Even the dissenting Judge, (TUTTLE, *J.*) said that Congress had imposed "an income tax"; that *"no effort* has been made in the act to impose an excise tax" (R. 53).

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* See Solicitor General's Brief, p. 19; Chas. E. Hughes' Brief, pp. 33-38.

(2) Mr. Justice BRANDEIS (dissenting) was, we think, in error when he said that,

> "Ever since Corporation Tax Act August 5, 1909 * * * the United States has laid upon life insurance companies a *special excise tax* measured by net income" (277 U. S. at 522).

Although the Corporation Tax Act of 1909 described the tax which it imposed as a *"special excise tax* with respect to carrying on or doing business" [which tax was sustained solely because it was in no sense an income tax but only an excise tax, *Flint* vs. *Stone Tracy Co.*, 220 U. S. 107, 147, 150, 151, 152, 167,] yet after the adoption of the 16th Amendment, the nine Revenue Acts of 1913, 1916, 1917, 1918, 1921, 1924, 1926, 1928 and 1932, described the taxes imposed therein by very different language. None of them described the tax as a "special excise tax" (as did the Corporation Tax Act of 1909), but every one of them described the tax as one on *"income"*. The pertinent provisions are collated in the margin.*

It is thus seen that all of these Acts, in practically the same language, impose specifically a tax directly upon a life insurance company's "entire net income", "total net income" or "net income". We do not recall that there

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* The Act of 1913 levied a tax "upon the *entire net income* arising or accruing from all sources . . . to . . . every insurance company." 38 Sta. 172.

The Acts of 1916 and 1917 levied "upon the *total net income* received in the preceding calendar year from all sources by every . . . insurance company . . . a tax of two per centum upon such income." 39 Stat. 765; 40 Stat. 333.

The Act of 1918 levied a tax "upon the *net income* of every corporation." 40 Stat. 1065-6.

The Acts of 1921, 1924, 1926, 1928 and 1932, levied a tax "upon the *net income* of every life insurance company." 42 Stat. 261; 43 Stat. 289; 44 Stat. 47; 45 Stat. 842; 47 Stat. 223.

has ever been a suggestion (other that from Mr. Justice BRANDEIS) that they were in the nature of a "special excise tax"; or that any of these Revenue Acts imposed an "excise" tax for the privilege of conducting the business of life insurance. The taxes were specifically designated as income taxes, *i. e.*, taxes upon *"income"*.

No doubt, had it chosen so to do, Congress might have imposed on life insurance companies, a "special excise" tax, measured by the net income; but it is not necessary to consider any question which might have arisen under some assumed hypothetical tax law which was never adopted.

Congress chose to tax life insurance companies (as it did individuals and other corporations), under the power to levy "income" taxes without apportionment; nor do we recall any suggestion that the taxes levied on the "income" of individuals and corporations by the series of Revenue Acts from 1913 to 1932 were not in fact "income" taxes, but were really *"special excise"* taxes. Until this Court decides that all of the specifically designated "income" taxes upon corporations, since 1913, are not "income" taxes at all, but are "special excise" taxes, it is needless to consider the subject further.

(3) *Massachusetts Mutual* vs. *U. S.*, 288 U. S. 269, was based upon the assumption that life insurance companies were subjected to an "income" tax rather than a "special excise" tax; because this Court assimilated life insurance companies to the same category as other taxpayers with respect to their "income" tax returns.

(4) The Revenue Acts of 1918, 1921, 1924 and 1926 [§238 (a)], and of 1928 and 1932 [§131 (a) (1)] pro-

vide for a credit to the taxpayer on his tax for the amount of any *"income"* tax paid to any foreign country. The Treasury Department has uniformly held that there can be no credit allowed for any *"excise"* tax paid to a foreign country; and that credit can only be had for taxes paid to a foreign country which are specifically designated as *"income"* taxes in such foreign country.*

This shows that the Government, administratively, will not permit an "excise" tax to be termed an "income" tax; and that the designation of a tax as an "income" tax is essential in order to be allowed as a credit when paid to a foreign country. If, then, in order to be an "income" tax within the meaning of our Revenue Acts so as to obtain a credit, it must be so designated in the foreign law imposing it, likewise when a tax is specifically designated as a tax on "income" in our Revenue Acts, it should not be held to be an "excise" tax in order to relieve it from the apportionment requirement.

(5) The Independent Life filed its return on Form 1120-L described by the Government, in large black type on the top thereof,

"Life Insurance Company Income Tax Return".

The return contains the words "gross income" once; "net income" *ten times,* and "income" twice.

Neither the word "excise" nor any other similar word is used. The same provisions as to abatements, refunds, overassessments, deficiencies, limitations and penalties apply to life insurance companies as apply to individuals and other corporations with respect to their *"income"* tax returns.

* If life insurance companies could get credit for "excise" taxes paid in a foreign country by calling them "income" taxes, the companies would obtain large further deductions.

Although there are many true "excise" taxes levied with respect to various kinds of business, it is not recalled that there is a single provision relative to such "excise" taxes which can be found anywhere in the law applicable to the "income" tax on life insurance companies here involved.

(6) *Flint* vs. *Stone Tracy Co.*, 220 U. S. 107, and *Stratton's Independence* vs. *Howbert*, 231 U. S. 399, arose under the 1909 Corporation Tax Act *before* any income tax had even been adopted. *Stanton* vs. *Baltic Mining Co.*, 240 U. S. 103, which arose under the 1913 Income Tax Act, was disposed of on the same grounds as *Brushaber* vs. *Union Pacific*, 240 U. S. 1; and its reference to *Stratton's Independence* was *dictum* and illustrative only.

The Government has cited no authority to lend any support to its suggestion that Congress, although specifically designating the taxation of life insurance companies as "income" taxation, nevertheless imposed, not an income tax, but a "special excise" tax.

SECOND POINT.

The taxation of the "rental value" of property, when occupied by its owner, was not a mere "correlation of deductions with the limited class of income to be taxed" (as the Government contends), but it was the levy of a "direct" tax upon real estate because the owner occupied it.

In order to avoid the "direct" tax difficulty, the Government urges that "Congress did not intend . . . to tax the rental value of space occupied by the owner"; that its only purpose was the *"correlation of deductions* with the limited class of income to be taxed"; and that the "inclusion in gross income of the rental value of the space owned and occupied by the taxpayers" was, in reality, a mere *"limitation upon the deductions"* (Government's Brief, pp. 8, 11, 17).

Without pretending to understand how a *tax* can be *upheld* by saying "Congress *did not intend*" to impose it, or how a *forced increase* in gross *income* can be called a *limitation upon deductions,* the Government's argument is based upon the following assumptions, each of which will be shown to be erroneous:

Government's erroneous assumptions.

(1) That a life insurance company's income consists of two *separate kinds* of income; one of which the Government terms *"Investment* income," and the other *"Underwriting* income."

(2) That Congress *taxed* the "Investment" income; but did *not* tax the "Underwriting" income: and Congress, thereby, conferred a great favor upon life insurance companies, by leaving a large part of their "income" *untaxed.*

(3) That, in authorizing the nine specific deductions (§ 245 (a) (1-9),), Congress *intended* to allow only deductions *connected* with the "Investment" income, which was to be *taxed.*

(4) That, in applying § 245 (a) (b), the Commissioner *must* administratively *carry out* the foregoing *assumed "intention"* of Congress, *regardless* of the language actually used in § 245 (a).

(5) That, when the company occupies *any part* of its building, then *all of the deductions* (6), (7) [Real estate taxes, expenses and depreciation] are *conclusively presumed* to be connected solely with the *"Underwriting"* income, which the Government assumes was *not* to be taxed; and hence to allow deductions (6), (7), would result in an unjustified "distortion" of the *"Investment"* income, which the Government erroneously assumes *was the only income to be taxed.*

Government's erroneous conclusions.

From the foregoing *erroneous assumptions,* the Government next deduces the following equally erroneous conclusions:

First; That Congress only intended to permit deductions (6) (7) [taxes, real estate expenses and depreciation] which were *directly connected* with earning so-called "Investment" income which was to be taxed, to wit, rents derived from tenants to whom portions of the building were rented; and that if a company, owning its own building, occupied *any part* of it, the benefit accruing from such ownership was in the nature of *"Underwriting"* income, which was *not* to be taxed;

Second; That, *consequently,* Congress never intended for the company to deduct (6) (7) [taxes, expenses and depreciation], if *any part* of the building were occupied by the company; but that, on account of the practical

difficulty of allocating such items between other tenants and the company itself, Congress attempted (to use the Government's phrase) "to correlate the deductions with the limited class of income to be taxed" (whatever that may mean), by providing that, whenever the company occupied any portion of its own building, if it deducted (6) (7) [taxes, expenses and depreciation] it *must include* as a part of its gross income, enough as "rental value" of the space it occupied, to bring out a net 4% return on the "book value" of the building.

We will now show the error in each of the Government's five erroneous assumptions.

(1) A life insurance company's income is not divided into two separate water-tight compartments known as "Investment" income and "Underwriting" income.

Wherever Congress has used the terms, "Investment income" and "Underwriting income", **it has expressly stated that those terms should not be applicable to life insurance companies*** (See pp. 66, 67, *infra*).

Prior to 1921, Congress did treat premiums received from policyholders as "income" to a life insurance company; but in order not to destroy the life insurance business, Congress allowed certain extraordinary deductions (not allowed to other corporations). But, as Solicitor General MITCHELL conceded in the *National Life* case, such a method of taxing *life* insurance companies "was unfair, unjust, and unsound in principle," because premiums paid by *life* policyholders *"are no more income to the company than are deposits in a bank income to the*

* See § 246 (a),(b) (3) (4) of the Revenue Acts of 1921, 1924, 1926, 42 Stat. 263, 43 Stat. 291, 44 Stat. 49; § 204 (a),(b) (3) (4) of the Revenue Acts of 1928 and 1932, 45 Stat. 844, 47 Stat. 226.

bank" (Brief, p. 12; our italics). Those italicized words of Solicitor General MITCHELL ought to be sufficient to demonstrate that there is no such thing as an *"Underwriting"* income to a *life* insurance company in any proper sense.

By the Revenue Act of 1921 Congress recognized its error in treating *life* insurance premiums as "income", even if it had tried to correct the error by allowing extraordinary deductions.

(2) By the Revenue Act of 1921 [the identic language of which has been carried forward into each of the subsequent Revenue Acts of 1924, 1926, 1928 and 1932] Congress completely changed its entire conception of what (from a taxation standpoint) constitutes a *life* insurance company's "income"; and Congress eliminated from "income" all premiums paid by policyholders.* Thereby, Congress authoritatively defined the "income" of a *life* insurance company to consist only of its "interest, dividends and rents." The B. T. A. made the keen forceful comment (R. 24):

> "By defining statutory gross income to include only interest, dividends and rents, the *intention was disclosed to omit all other factors from consideration. National Life Insurance Co.* v. *United States, supra. The effect* otherwise would be *to include* premium receipts in gross income to the uncertain extent necessary to make up in each case for items improperly included, such as interest from State securities, or capital property like stock dividends, and thus *to defeat* the manifest legislative *purpose to leave premium receipts entirely out of the income taxed.* Thus to Congress would be ascribed the recondite purpose of *ostensibly releasing* premiums from tax while *actually requiring them to be used to validate particular taxes which would otherwise invade constitutional rights.*

We reject this and treat the statute as candidly expressing its design and purpose."

From 1921 to the present time, a *life* company's "income" has consisted of nothing but its "interest, dividends and rents"; and if such items are to be called *"Investment"* income it only means that (from the standpoint of income taxation) such items constitute the *sole* "income" of a *life* insurance company.*

The Government repeatedly refers to premiums paid by policyholders as the company's *un*taxed "Underwriting" income. While such so-called "Underwriting" income *is not taxed*, this is not because it is *omitted* from taxation, but, because (from a taxation standpoint), Congress properly decided that it was *not* "income" in any proper sense.

Congress defined, and then taxed, that which constituted "income" to a life insurance company. It is not material whether such "income" be called merely "income," or *"Investment"* income, or any other catch-word to designate it. No so-called "Underwriting" income was left *un*taxed.

When, in 1921, Congress corrected its former error and changed its conception of what constitutes "income" to a *life* company, it did not leave *un*taxed any amount of "income", or thereby confer some special favor upon *life* companies, which might seem to authorize the Com-

* As Solicitor General MITCHELL perceived, Congress ought never to have included "premiums" as any part of a life insurance company's "income," just as Congress never included "deposits" in the "income" of a bank. Congress always followed the correct idea in taxing "income" of banks; but from 1913 to 1921, Congress did not follow the correct idea as to life insurance companies, even though it tried to counter-balance its error by allowing certain extraordinary deductions to the *life* companies.

missioner to seek some unexpressed congressional intention, in order to counter-balance the supposed favor, by imposing some extra burden upon the companies.

Congress determined upon the method of taxing the "income" of *life* companies, and upon the deductions to be allowed. There was no question of *favor* to the companies, or of *omission to tax* any part of their "income". An authoritative and comprehensive plan was adopted, which should be carried out as laid down by Congress, rather than according to the Commissioner's view of some supposed, but unexpressed, "intention" of Congress.*

(3) As Congress did not subdivide a life insurance company's "income" into (*a*) an "Investment" income *to be taxed*, and (*b*) an "Underwriting" income to be left *un*taxed, it necessarily follows that the deductions authorized by § 245(a)(1-9) were intended by Congress to be deducted from the Company's total "income" as defined by Congress.

Congress never intended that such deductions should be *allowed only* in connection with what the Commissioner elects to style *"Investment"* income; and, in some undefined way, *kept separate* from what the Commissioner choses to designate as a so-called *"Underwriting"* income.

The basis of the Government's argument in the case at bar is that with reference to the deductions in controversy [*i. e.*, (6) (7), relating to taxes, expenses and depreciation on the building *occupied by the owner*], Congress had *two unexpressed* "intentions", to wit,

* As a matter of fact, for many years past, life insurance companies, on account of increased policy claims and deferred dividend business vanishing, would have paid considerably less tax under the old (1913-1920) method of taxation than under the 1921 Act's definition of "income".

First; That those deductions (6) and (7) should be allowed only in connection with "rents" collected from tenants; and

Second; That those same deductions (6) and (7) should be *disallowed* if the owner *occupied* any part of his own building, instead of renting the whole building to other tenants.*

The foundation of the Government's argument in the case at bar is destroyed, when it is once demonstrated (p. 41 *supra;* pp. 66, 67 *infra*), that a company's income is *not* segregated into "Investment" income and "Underwriting" income, upon which the Government can superimpose an *implied* "intention" of Congress that the specific deductions allowed should be further restricted to such further *"Investment"* income!

(4) In view of the plain, unambiguous language of § 245(a)(6)(7), and of the foregoing arguments, it is clear that Congress did not have any *unexpressed* "intention" that deductions (6) (7) should be allowed as to that part of the building producing what the Commissioner styles "Investment" income, and *disallowed* as to that part of the building *used* by the owner in the production of what the Commissioner styles "Underwriting" income.

(5) The deductions under § 245(a)(6)(7) of taxes, expenses and depreciation on the Independent Life building (of which only one floor was occupied by the company) were not, as the Government assumes, exclusively connected with the imaginary *"Underwriting"* income

* Unless, of course, the owner would submit to the void tax on the "rental value" of the space he occupied solely by reason of ownership.

claimed to be *un*taxed—which is the basis of the Government's argument in this case; but those deductions were directly connected with the Independent Life's *general* "income," *which was taxed.*

From eleven stories of the building which were occupied by tenants, with perhaps some vacant space, there were $70,000 rentals collected from tenants, and only one floor was used by the company (pp. 4, 5, *supra*). The Government claims that the allowance of deductions (6) (7) would result in a "distortion" of the imaginary *"Investment"* income, which was to be taxed. Obviously, the assumption which the Government has made in these respects is entirely erroneous, for the reasons heretofore pointed out, to wit, that the Independent Life's "income" was not segregated into *two separate water-tight compartments,* one consisting of so-called "Investment" income, subject to taxation, and the other, "Underwriting" income, *omitted* from taxation; but the Independent Life had one homogeneous "income" as defined by Congress; and there was, from the standpoint of income taxation, *no income left untaxed.*

In the case of the Rockford Life which occupied its *entire* building, the Commissioner disallowed *all* the $4,033.05 deductions for taxes, expenses and depreciation, because, according to the Commissioner's *theory,* they were connected with *un*taxed *"underwriting"* income, and the Rockford Life failed to consent to be taxed on the "rental value" of its own building.

Having shown the erroneous character of the five assumptions upon which the Government's argument rests, its conclusions are vitiated.

The unconstitutionality of a tax (without apportionment) upon the "rental value" of property, *only when occupied by the owner,* cannot be saved upon the theory that the tax is not a tax, but is a mere "correlation of deductions"! After a taxpayer has been *compelled to pay a tax* on "rental value" he can never believe that it is not a *tax,* but only a beneficent "correlation of *deductions.*"

The Commissioner's theory that the tax on "rental space" is *not* a tax, but is a "correlation of *deductions*", based on his separation of "Investment" and "Underwriting" income, *plus* his theory of Congressional "intention", becomes so confused that it is needless to follow it further.

THIRD POINT.

The Government's theory,

> ***(a) That the Revenue Act allowed deductions (6), (7), solely upon condition that the insurance company would consent to a tax upon the "rental value" of the real estate which it occupied; and (consequently),***
>
> ***(b) That having taken deductions (6), (7), the insurance company is estopped from contesting the constitutionality of the "direct" tax upon the "rental value,"***

is untenable; because Congress cannot impose an "unconstitutional condition", to wit, that a person shall surrender or waive a constitutional right as the price of receiving some benefit allowed to others.

The Government contends that the deductions allowed by § 245 (a) (6) (7) were granted "upon a condition", to wit, that the Company should, as the price of receiving such

deductions, include as a part of its income a large enough sum as the "rental value" of the space it occupied, to produce a *net taxable income* of 4% on the "book value" of the entire building; and that the company was *given the option* between (1) taking the deductions and submitting to the tax, or (2) not taking the deductions and not paying the tax, saying (Government Brief, pp. 28, 11, 30):

> "The allowance of deductions from taxable income . . . is a matter of legislative sufferance or permission. A reasonable condition attached to the allowance should not be open to question by one who has claimed the deduction allowed * * *.
>
> § 245(b) makes the taking of the deductions *conditional* upon the inclusion in gross income of the rental value of the space owned and occupied by the taxpayer . . . There is no compulsion involved, for the taxpayer *has an option* and is not required to report or account for the rental value of the space occupied by it unless it decides to claim the deductions. In each case the insurance company is free to weigh the practical advantage to it involved in *exercising the option* provided by statute."

To that argument, we reply:

I. The Government's theory limits the "condition" solely to *ownership* of land, when *occupied* by the owner by virtue of his ownership. This makes land, *when owned and occupied by the owner*, the sole basis of the classification by which the taxation of "rental value" is imposed. But that is precisely what the framers of the Constitution intended to prevent by their *twice repeated* prohibition against "direct" taxes (without apportionment). They intended to prevent any tax being levied on the basis of *land* ownership (Cf. pp. 13 note, 15-16 note, 20 note, *supra*).

II. The Government made exactly the same argument* in *National Life Ins. Co.* v. *U. S.*, 277 U. S. 508, where it was rejected as follows:

> "The suggestion that, as Congress may, or may not, grant deductions from gross income at pleasure, it can deny to one and give to another, is specious but unsound * * * Congress had no power purposely and directly to tax State obligations *by refusing to their owners deductions allowed to others.*"

As there, so here:

By § 245(a) (6) (7) Congress, first, allowed generally to *all* life insurance companies, deductions for taxes, real estate expenses and depreciation. But after doing so, Congress, second, by § 245(b), said that no *life* company *which owned and occupied any part of its own land* could take those deductions, *"unless"* such company consented to be taxed on the "rental value" of its own-occupied-land upon the arbitrary "book value" basis heretofore explained (pp. 26-33, *supra*). But as that "rental value" tax is a void "direct" tax (pp. 13-26, *supra*), Congress simply attempted, as in the *National Life* case, to attain a prohibited result "by refusing to their owners deductions allowed to others" (277 U. S. 522). It refuses to life companies which *occupy* their own land, the deductions which it allows to all other life companies who do *not* occupy their own land—thus making the owner's *occupancy* of his own land the basis of distinction, unless the latter will submit to a "direct" tax on his land.

* That the Government had unlimited power to grant or refuse deductions to a taxpayer; that it could grant a deduction upon "condition" that the taxpayer submit to such qualification or limitation as Congress prescribed; and, specifically, that Congress could *limit* the deduction allowed of 4% of Reserve, by the amount of the taxpayer's *tax-exempt income.*

In one respect, the case at bar is even stronger than the *National Life* case. There, the same § 245(a) (1) (2) allowed the deduction of tax-exempt income, but said that another deduction should be merely *reduced* by the amount of such tax-exempt income; and the prohibited result sought to be attained was the taxation of State bonds, which, after all, only came from an *implied* prohibition arising out of this Court's prior decisions against taxing State bonds. Here, the same § 245, *first* allowed the deductions (6) (7), but then says—not that they shall be merely *reduced*, but that they shall be *denied* in *toto*, unless the company submits to this void "direct" tax, which the Constitution itself *twice expressly prohibits*.

Where the Constitution expressly prohibits Congress from doing something, can Congress say to Taxpayer A, "We will grant you such a deduction,"; and then say to Taxpayer B, "We refuse to you the deductions we have just granted to A, unless you consent to pay the tax which the Constitution prohibits us from levying on you."?

III. The allowance of deductions from income is a matter of Congressional permission; but the power to grant or refuse deductions, does not give Congress the absolute power to make a *conditional* deduction. The moment that Congress undertakes to grant a deduction "*upon a condition*" (as the Government frankly admits (p. 28) it has done in this case), we are faced with the question of "unconstitutional conditions," so earnestly debated in this Court for half a century, resulting in the settled rule that even the possession of an unqualified power (absolute and unconditional in terms), does not carry with it the uncontrolled right to exercise such

power in a *conditional* manner; and if the power is exercised in a conditional manner, the condition must not be repugnant to, or require the surrender of, any right secured by the Constitution.*

A condition requiring a taxpayer to submit to a direct tax upon his land without apportionment, *is* repugnant to the Federal Constitution.

The power to impose conditions cannot be used to accomplish a prohibited result (*Miller* v. *Milwaukee*, 272 U. S. 713, 715; *Nichols* v. *Coolidge*, 274 U. S. 531, 541-2).

Congress cannot say to a citizen, "We grant you such and such a privilege 'upon condition' that you permit your property to be taken by Congress without due process of law,"; nor can Congress grant to one State the right to build bridges over navigable rivers "upon

* Although the *Doyle* and *Prewitt* cases held that a State might grant a foreign corporation the right to do business in the State upon condition that it should lose that right if it removed a case to the Federal Court, this Court *abandoned that doctrine*, upon the ground that a condition repugnant to the Federal Constitution, could not be imposed. Contrast majority and dissenting views in *Doyle* v. *Continental Ins. Co.*, 94 U. S. 535, 542, 543; *Security Mutual* v. *Prewitt*, 202 U. S. 246, 257-259, *et seq.*; *Western Union Tel. Co.* v. *Kansas*, 216 U. S. 1, 30-48, 54, 55; *Pullman Co.* v. *Kansas*, 216 U. S. 56, 62, 75; *Ludwig* v. *Western Union Tel. Co.*, 216 U. S. 146, 163.

Compare *Southern Ry. Co.* v. *Greene*, 216 U. S. 400, 416; *Herndon* v. *C. R. I. & P. Ry.*, 218 U. S. 135; *Harrison* v. *St. L. & San Francisco R. R.*, 232 U. S. 318, 328, 332, 333; *Phoenix Ins. Co.* v. *M. Masters*, 237 U. S. 63, 71; *Wisconsin* v. *Phila. & Reading Coal Co.*, 241 U. S. 329; *Terral* v. *Burke*, 257 U. S. 529; *Mortensen* v. *Security Ins. Co.*, 289 U. S. 702.

For a full history of the battle over "unconstitutional condition," see Appellee's Brief (p. 30-76), in the *Terral* case, 257 U. S. 529, and Appellee's Brief (p. 30-80) in the *Mortensen* case, 289 U. S. 702.

condition that such State shall consent that Congress may give a preference to the ports of some other State over its own ports.

Can Congress grant to all taxpayers generally certain deductions from their income and then annex the "condition" that any taxpayer who is the "*owner*" of a house must, in order to obtain the deductions granted, consent that soldiers in time of peace be quartered in such house?

In *Frost Trucking Co.* v. *R. R. Com.* 271 U. S. 583, 593, it is said:

> "It would be a palpable incongruity to strike down an act of state legislation which, by words of express divestment, seeks to strip the citizen of rights guaranteed by the federal Constitution, but to uphold an act by which the same result is accomplished *under the guise of a surrender of a right in exchange for a valuable privilege which the state threatens otherwise to withhold.* It is not necessary to challenge the proposition that, as a general rule, the state, having power to deny a privilege altogether, may grant it upon such conditions as it sees fit to impose. But the power of the state in that respect is not unlimited; and one of the limitations is that **it may not impose conditions which require the relinquishment of constitutional rights. If the state may compel the surrender of one constitutional right as a condition of its favor, it may in like manner, compel a surrender of all. It is inconceivable that guaranties embedded in the Constitution of the United States may thus be manipulated out of existence.** * * *
>
> May it stand in the conditional form in which it is here made? If so, constitutional guaranties, so carefully safeguarded against direct assult, are open to destruction by the indirect but no less effective process of requiring a surrender, which though, in form voluntary, in fact lacks none of the elements of complusion. Having regard to form alone, the act here is an offer to the private carrier of a privilege, which the state may grant or deny, upon a condition, which the carrier is free to accept or reject. In reality, the carrier is given no choice, except a choice between the rock and the whirlpool,—an option to forego a privilege which may be vital to his livelihood or submit to a requirement which may constitute an intolerable burden."

IV. If this Court shall decide that § 245 (b) is constitutionally permissible, then whenever a taxing authority, State or Federal, wishes to accomplish a prohibited result, it may do so by providing that unless the taxpayer agrees to submit to the thing prohibited, he shall not be allowed to receive Deductions otherwise allowable. The door will be wide open for the States, as well as for Congress, by simple statutory amendments, to nullify many of this court's most important rulings as to tax-exempt property.

A few illustrations will be illuminating:

In *Evans* v. *Gore*, 253 U. S. 245, the Revenue Act of 1918 gave to taxpayers generally the right to certain Deductions summarized in the margin.*

This Court held that § 213 was void as applied to Federal Judges' salaries, because it required the inclusion of such salaries in their return of income. Thereafter a Federal Judge, in returning his income, was entitled to omit his salary.

Suppose that in order to evade *Evans* v. *Gore*, Congress should apply the device of § 245(b) to the case of Federal Judges, by providing that none of the above Deductions allowed to taxpayers generally should be made by a Federal Judge, **unless he included his salary in his return of income.**

A Federal Judge would have the same free option which the Government insists in the case at bar is open to an insurance company, namely, he could either (1) avoid an unconstitutional tax, but, in such event, he could not receive the Deductions given to all other taxpayers; or

* The Deductions so allowed were for interest paid on debts, taxes, losses, bad debts, depreciation and charitable contributions. (Revenue Act of 1918, § 214; 40 Stat. 1066).

(2) he could accept the amended Act, receive the Deductions which tax payers generally receive, **and submit to the unlawful tax.**

Would this court approve such a device for evading the constitutional exemption of the Federal judiciary from a diminution of their compensation during their terms of office?

Suppose a Federal Judge claimed the Deductions allowed other tax payers, but did not return his salary as part of his income. Could it be said, as the Government argues here, that the Federal Judge, having taken the Deductions, would be estopped from disputing a tax upon his judicial salary? We submit that such an amended Act would be void because it made the granting of Deductions generally, subject to a condition that a Federal Judge should submit to an unconstitutional tax upon his salary.

In each of the leading cases cited in the margin*, a State taxing statute gave to the tax payer certain Deductions; and in each instance this Court held that the statute was void because the tax payer was entitled to an additional Deduction on account of some item of property which the State had no constitutional power to tax. Could New York, Kentucky, California, Pennsylvania, Wisconsin and Missouri evade this court's decisions by amending their respective Acts (in exact accordance with the device of § 245(b)), by providing that the tax payer should not have the regular Deductions allowed other tax

* *People* v. *Weaver*, 100 U. S. 539; *Louisville & Jeffersonville Ferry Co.* v. *Kentucky*, 188 U. S. 385, *Bank of California* v. *Richardson*, 248 U. S. 476, *Frick* v. *Pennsylvania*, 268 U. S. 473, *Miller* v. *Milwaukee*, 272 U. S. 713, *Northwestern Mutual Life Ins. Co.* v. *Wisconsin*, 275 U. S. 136, *National Life Ins. Co.* v. *U. S.*, 277 U. S. 508, *Missouri* v. *Gehner*, 281 U. S. 313.

payers, unless he would consent to be taxed upon the particular item which this Court had said could not be taxed?

To illustrate: *In Frick* v. *Pennsylvania*, 268 U. S. 473, the State Inheritance Tax Law permitted the deduction of "Debts and administration expenses" from the gross estate. This Court held that Pennsylvania could not tax certain tangible personalty in New York and Massachusetts, which must be deducted from the gross estate before it was taxed.

Suppose that Pennsylvania, in order to defeat the doctrine of the *Frick* case, had adopted an amended statute which provided that no estate should claim a deduction for "Debts and administration expenses", unless it consented to be taxed on the tangible property in other states.

Would such a law be valid?

V. The B. T. A. aptly said (R. 31):

> "It should not be overlooked that the condition of paragraph (b) is not applicable alone to such amount of the deductions under (6) and (7), *as compares with space occupied*, but operates as a condition of such deductions in any amount in respect of *the whole building*. Unless the taxpayer returns as gross income the rental value of the one story occupied, *it may not have any deductions whatever* of the charges applicable to any part of the building, notwithstanding all rents received are returnable. The alternative given is to pay tax on gross rents received without deduction or to pay tax on net rents received plus rental value of space occupied. This, we think, is subject to at least the objection stated by the Supreme Court in the *National Life Insurance Co.* case, and is consequently an invalid provision."

The C. C. A. (6th) said (R. 52):

> "Respondent has accepted no benefits under sec. 245 (b) of either act. None are in effect granted therein. It

has chosen, as it had a right to, to claim deductions allowed by sec. 245 (a)(6) and (7) of each act and to resist deficiency assessments founded upon the compulsory inclusion in gross income of that which cannot in any sense be regarded as income. The record fails to disclose that respondent has acquiesced in the provisions of these sections or recognized them as valid. See *Frost* v. *Corporation Commission*, 278 U. S. 515, 528. We therefore conclude that the inclusion of the indicated items in respondent's gross income for 1923 and 1924, respectively, as the rental value of the space occupied by it in its building, was in effect the taxation of something nontaxable (*Evans* v. *Gore*, 253 U. S. 245; *Miles* v. *Graham*, 263 U. S. 501) and was invalid.

"It is said that the purpose of sec. 245 of each act was, not to include in gross income that which was not income, but to *limit the deductions*. * * * It is urged that this may be done because deductions are statutory, and, although income is controlled by the Constitution, Congress may grant deductions or withhold them entirely or limit the amounts thereof. * * *

Congress may of course allow to all life insurance companies the deductions granted in sec. 245(a) (6) and (7), but having done so it cannot then say that it will deny these same deductions to those life insurance companies which own and occupy in whole or in part their own real estate unless they submit to taxation upon income which is nonexistent."

Judge Tuttle's dissent in the C. C. A. (6th) (R. 54-55) presents the same argument that was unsuccessfully made by the Government in the *National Life* case. The thing which Judge Tuttle urges is identically the thing that the *National Life* case decided *could not be done.*

We agree with his illustrations—both algebraically *and* constitutionally.

Indeed that was the precise argument which the *National Life* successfully made. The trouble with Judge Tuttle's argument is that if a tax on "rental value" is tax-exempt (without apportionment), then this Court held in the *National Life* case that the two equations given by Judge Tuttle were *identical* and both *equally unconstitutional.*

NO. 722: ROCKFORD LIFE CASE

"FURNITURE AND FIXTURE" CONTROVERSY

FOURTH POINT.

1. The Rockford Life was entitled to an allowance of $1,783.02 for depreciation on all its furniture and fixtures.

2. It should not be limited to an allowance of only $292.56 upon the small quantity of furniture and fixtures used exclusively in what the Commissioner calls the "Investment" department of its business.

Relevant Statute.

§ 203(a)(7) of the Revenue Act of 1928 (45 Stat. 791, 842-3) provided that a life insurance company was entitled to deduct from its "gross income",

> "(7) DEPRECIATION—A reasonable allowance for the exhaustion, wear and tear of property, including a reasonable allowance for obsolescence."

The Facts.

It was stipulated (No. 722; R. 14):

1. "A reasonable allowance for depreciation" of the Rockford Life's "furniture and fixtures for 1929 was $1783.02."

2. But the Commissioner allowed only $292.56, because the Commissioner held that the $1490.46 "balance of depreciation on furniture and fixtures applied to petitioner's [Rockford Life] insurance business and was therefore not deductible."

The Contentions of the Parties.

The Rockford Life contends that § 203(a) (7), *supra,* meant exactly what it said, viz. a deduction of "a reasonable allowance" for depreciation *"of property"*, which, by express stipulation, *supra,* was $1,783.02 for the furniture and fixtures (No. 722; R. 15; 27 B. T. A. 1419).

On the other hand, the Commissioner contends that § 203(a)(7) should be *construed* to limit the deductible depreciation to *such property only* [in this case "furniture and fixtures"], as the company *"used"* in what the Commissioner termed the *"Investment* Department" (No. 722; R. 7); and that it could not deduct any depreciation upon furniture and fixtures used in what he chooses to call "the *underwriting* department of the company" (No. 722; R. 23-24; 67 F. (2d) 213).

The Decision Below.

The B. T. A. decided that the Rockford Life was entitled to the agreed $1,783.02 allowance for depreciation on *all* of its furniture and fixtures, upon the authority of the B. T. A.'s settled rule on that subject as expressed in *Lafayette Life Ins. Co.,* 26 B. T. A. 946,951, followed in *Manhattan Life Ins. Co.,* 28 B. T. A. 129, *Missouri State Life Ins. Co.,* 29 B. T. A. , and *North American Reassurance Co.,* 29 B. T. A. [No. 722; R. 15; 27 B. T. A. 1419].

The C. C. A. (7th) reversed the B. T. A., upon the authority of its opinion in *Com'r* vs. *Lafayette Life,* 67 F. (2d) 209, 211 (No. 722; R. 23; *Com'r* vs. *Rockford Life,* 67 F. (2d) 213).

We submit that the B. T. A.'s decision was correct, and that the C. C. A. (7th) was in error, for the following reasons:

I. Legislative History.

(1) The Revenue Acts of 1916 and 1917 in identic language, and of 1918 in almost identic language, provided that all corporations, including *all insurance companies,* should be entitled to

> "a reasonable allowance for the exhaustion, wear and tear *of property* arising out of its use or employment in the business or trade."*

Therefore, from 1909 until 1921 Congress gave to *every* insurance company an allowance for depreciation "of property" *used or employed in its business.*

(2) By the Revenue Act of 1921, followed by identic language in the Revenue Acts of 1924, 1926, 1928 and 1932† the previous restriction to "use or employment in the business or trade" was *omitted* as to life insurance companies. It was provided that *life insurance* companies—distinct from all other corporations and distinct from *all* other kinds of *insurance* companies—were entitled to

> "DEPRECIATION—A reasonable allowance for the exhaustion, wear and tear *of property,* including a reasonable allowance for obsolescence."

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* The Revenue Act of 1916, § 12(a), 39 Stat. 756, 768; Revenue Act of 1917, § 12(a), 40 Stat. 300; Revenue Act of 1918, § 234(a)(7), 40 Stat. 1057, 1077-8 (Cf. Corporation Tax Act of August 5, 1909, § 38; 36 Stat. 11, 112; Act October 3, 1913, Section II G(b), 38 Stat. 114, 172).

† § 245(a)(7) of the Revenue Acts of 1921, 1924 and 1926, 42 Stat. 227, 261, 264; 43 Stat. 253, 289, 290; 44 Stat. 9, 47, 48; and § 203(a)(7) of the Revenue Acts of 1928 and 1932, 45 Stat. 791, 842-3; 47 Stat. 169, 224, 225.

By the 1921-1932 Revenue Acts just quoted, Congress did not place any limitation as to the character or the use *of property* on which a *life* insurance company was entitled to claim a depreciation allowance. But on the contrary, Congress gave to *life insurance* companies—as distinguished from corporations generally and from all *other* kinds of *insurance* companies—the broadest possible description of the property on which a depreciation allowance might be claimed by a *life insurance* company; *i. e.*, instead of limiting the depreciation allowance on property to that *"arising out of its use or employment in the business or trade,"* as was provided prior to 1921, Congress omitted those *italicized* qualifying words. While retaining part of the old phraseology, *i. e.*, "a reasonable allowance for the exhaustion, wear and tear *of property*" Congress deliberately *omitted* the former qualification as to "use or employment in the business or trade." That change in language shows that Congress intended that, after 1921, *life* insurance companies should have "depreciation" on *all their property*, whether or not it was used or employed in the business.

(3) As if to emphasize and reinforce that Congressional intention on this subject, the Revenue Acts of 1921, 1924, 1926, 1928 and 1932 continued to provide as to corporations generally, and as to all insurance companies *other* than *life* insurance companies, that the allowance for depreciation should continue to be limited to property "used in the trade or business".*

*§ 234(a)(7) of the Revenue Acts of 1921, 1924 and 1926, 42 Stat. 227, 255, 43 Stat. 253, 284, 44 Stat. 9, 42; § 23(K) of the Revenue Acts of 1928 and 1932, 45 Stat. 791, 800, 47 Stat. 169, 181.

It would be difficult to find a more striking and conclusive proof that Congress intended that *life* insurance companies should be entitled to a reasonable allowance for depreciation upon *all* of their "property," because, *First,* Congress *changed the old language* in order to express that intention; while, *Second,* at the same time, as to corporations generally and as to all insurance companies *other* than *life* insurance companies, Congress *retained* the old language of the Revenue Acts of 1916-1918 still limiting as to them, the depreciation of property to such as arose *"out of its use or employment* in the business or trade."

II. Administrative History.

For nearly ten years after the passage of the 1921 Revenue Act, the Commissioner (overlooking or disregarding the fact that there was an even broader provision for depreciation as to *life* insurance companies than was applicable to corporations generally and to *other* kinds of insurance companies) held that the depreciation deductions allowed to *life* insurance companies were *"identical"* with those allowed to other corporations.*

Accordingly, during that period of nearly ten years, the Commissioner allowed to all *life* insurance companies a reasonable allowance for the depreciation of *all* of their "furniture and fixtures" without distinction as to the *particular use* they were put to in the company's business.

About 1930 or 1931 the Commissioner (abandoning his practice of ten years) conceived the new idea that,

* Cf. Art. 685(2) of Regulations 62 under Revenue Act of 1921, Regulations 65 under Revenue Act of 1924; and Regulations 69 under Revenue Act of 1926; Art. 975(2) of Regulations 74 under Revenue Act of 1928; Art. 975(2) of Regulations 77 under Revenue Act of 1932. See quotation from B. T. A. opinion, page 64, *infra.*

as to the "furniture and fixtures" of a *life* insurance company, he should only allow depreciation thereon to the extent that such "furniture and fixtures" were used in what he termed the "*Investment* Department" of the company's business; and that he should disallow any depreciation on the "furniture and fixtures" used in all the balance of the company's business, as, for example, in the actuarial, medical, legal, executive, underwriting, premium collecting, and policy issuing Departments of the company.

This new departure of the Commissioner was erroneous in three distinct particulars:

(1) He disregarded entirely the fact that *life* insurance companies were given a depreciation allowance on their "property", without regard to its use or employment in business;

(2) Disregarding that fact, he proceeded to treat *life* insurance companies on a far harsher basis than corporations generally were treated, and than insurance companies *other* than *life* companies were treated.

(3) The Commissioner thus completely *reversed* the Congressional provisions. Instead of giving *life* insurance companies a *more* favorable depreciation treatment than other corporations, he actually gave them a much *less* favorable treatment!

It was this departure by the Commissioner from his former practice that brought on the *Lafayette Life* and *Rockford Life* cases to challenge his changed method of allowing depreciation on "furniture and fixtures," although there had been no change in either the Revenue Acts or in the Commissioner's Regulations thereunder.

III. The Correct Application of § 203(a)(7) of the Revenue Act of 1928.

It is expressly stipulated that "a reasonable allowance for depreciation of petitioner's [Rockford Life] furniture and fixtures for the year 1929 was $1,783.02" (No. 722; R. 14). This STIPULATION OF FACT, which is binding on this Court, removes from controversy every possible question as to what constitutes a *"reasonable allowance* for depreciation of the furniture and fixtures" owned by the Rockford Life.

The only question open for consideration is whether under § 203(a)(7), providing for a reasonable allowance for the depreciation of the Rockford Life's "property," the Commissioner could arbitrarily sub-divide its "furniture and fixtures" into two classes, *i. e.,* (1) that which was used in what he terms the "investment" department and (2) that which was used in all other departments of the company; and then to allow depreciation on that used in the "investment" department, and to deny depreciation on all the balance.

There is nothing in the language of the statute, or in the legislative or administrative history to justify the Commissioner's action.

Congress has never given the slightest support to any such application of its plain and unambiguous language granting to life insurance companies a depreciation allowance on their "property."

The Commissioner's action in splitting up the "property" into two kinds, according to the *use* to which the "furniture and fixtures" were put, was wholly unjustified.

The B. T. A.'s established view on this question was

thus expressed in *Lafayette Life Insurance Company*, 26 B. T. A. 946, 951:

> "The last question raised by the respondent [Commissioner] is whether petitioner [Lafayette Life] is entitled to deductions for depreciation of furniture and fixtures used in the underwriting portion but not in the investment portion of its business. The provisions of the Revenue Act of 1926 which are applicable here are as follows:
>
> Sec. 244. (a) In the case of a life insurance company the term 'gross income' means the gross amount of income received during the taxable year from interest, dividends and rents. * * *
>
> Sec. 245 (a) In the case of a life insurance company the term 'net income' means the gross income less— * * *
>
> (7) A reasonable allowance for the exhaustion, wear and tear of property * * *.
>
> The respondent [Commissioner] contends that, as the statute confines petitioner's [Lafayette Life] gross taxable income to receipts of interest, dividends and rents, therefore, the deductible allowance for depreciation of property logically and properly includes only such property as petitioner [Lafayette Life] used in the production of its taxable income.
>
> In our opinion that contention is not well founded.
>
> In Regulations 69, construing the revenue act, the respondent [Commissioner] says, in Article 685(2), that 'The deduction allowed by § 245(a)(7)* for depreciation is identical* with that allowed other corporations by § 234(a)(7).' That limits the allowance for depreciation to the 'exhaustion, wear and tear of property used in the trade or business.' Unquestionably the trade or business of this petitioner [Lafayette Life] covered not only investments of its funds, but the writing and issuance of life insurance policies, collecting premiums, and the like. While

* [The B. T. A. did not comment on the facts that, after the 1921 Act, *the Regulations were in error* in saying that the depreciation deduction was *"identical"* for insurance companies and *other* corporations. Cf. (2) (3), pages 59, 60, 61, note, 62 (1) (2) (3), *supra.*]

there were two phases of petitioner's [Lafayette Life] activities, **the underwriting and the investment, the two combined constituted its business. Each was dependent upon and related to the other, and both were necessary factors for the success of the business.**

Had Congress desired to limit the depreciation allowance in the manner now urged by respondent [Commissioner], it would undoubtedly have so worded the statute. No such limitation is expressed, however, and we find nothing in the statute to indicate an intention to create such a restriction. In our opinion, therefore, the petitioner [Lafayette Life] is entitled to the amounts claimed by it for depreciation on its furniture and fixtures, namely, $788.88 for the year 1926 and $861.40 for the year 1927."

The C. C. A. (7th) based its reversal of the B. T. A. upon the erroneous assumption that a life insurance company was only taxed upon so-called "investment" income; and that, consequently, its *deductions* ought to be limited to those arising out of its "*investment*" business. (No. 722 R. 23; Cf. *Com'r* vs. *Lafayette Life*, 67 F. (2d) 209, 211).

To that argument we respond;

(1) We are applying a plain, unambiguous statute which contains nothing to justify an arbitrary "splitting up" of the objects to which the statute applies.

(2) For ten years, neither the Commissioner nor anyone else ever thought of "splitting up" the "property" to which the statute applied into a couple of arbitrary "classes", according to the use to which the "property" was put, *applying* the statute to one and *rejecting* it as to the other.

(3) The C. C. A.'s (7th) decision was based upon the erroneous assumption that a *life* insurance company has

an "investment" income that *is* taxed, and an "underwriting" income that is *not* taxed; whereas, Congress has *never* applied either the term "investment" or the term "underwriting" to a *life* insurance company, but it has authoritatively *defined* what constitutes *all* of the taxable *income* of a life insurance company.

A life insurance business is a homogeneous whole requiring, on the one hand, the collection of premiums from its policyholders for the sole purpose of investing and reinvesting them, so as to pay out of its assets (as a whole) the death claims of its policyholders as they respectively die, paid-up policies as they mature, surrender values when demanded, and then to return to the policyholders, in shape of annual dividends, any overpayments which policyholders have made in premiums, not necessary to be used for the payment of death losses, maturities, surrender values and expenses.

There is no justification for "splitting up" a mutual life insurance company into a so-called "investment" branch and an "underwriting" branch. Congress has never applied the terms "investment income" and "underwriting income" to a *life* insurance company. Those two expressions were first used by Congress in the Revenue Act of 1921, (continued in identic use in the subsequent Revenue Acts of 1924, 1926, 1928 and 1932), but in each of those Acts, those terms were expressly stated to be applicable to "every insurance company (*other than a life* or mutual insurance company)".* Therefore, when Congress in its only use of the terms "investment income" and "underwriting income", expressly provided that they *should not*

* See § 246 (a), (b) (3) (4) of the Revenue Acts of 1921, 1924, 1926, 42 Stat. 263, 43 Stat. 291, 44 Stat. 49; § 204 (a), (b) (3) (4) of the Revenue Acts of 1928 and 1932, 45 Stat. 844, 47 Stat. 226.

apply to a life insurance company, there is certainly no justification for the C. C. A. (7th) or for the Commissioner to fritter away the plain language of a statute applying to life insurance companies, by applying to them two phrases, which Congress expressly provided *should not apply* to life insurance companies.

(4) In its opinion in the *Lafayette Life* case, 67 F. (2d) 209, 211, the C. C. A. (7th) quotes the words, "reasonable allowance for obsolescence"; and asks the rhetorical question, "What significance has the word 'reasonable'?"

Whatever relevancy, if any, the provision for "obsolescence" may have had in the *Lafayette Life* case (and we are unable to perceive any relevancy there), it certainly has no sort of relevancy in the *Rockford Life* case, where no question of obsolescence was involved, and the word "obsolescence" does not even appear anywhere in the Record.

(5) The Commissioner both "determined" and "stipulated" that a "reasonable allowance" for depreciation of the Rockford Life's furniture and fixtures for 1929 was $1,783.02. That STIPULATION automatically eliminated any question as to the "reasonableness" of the amount so stipulated. "Reasonable allowance" for depreciation refers to the *basis* adopted to measure the depreciation. The necessary elements in computing depreciation are (1) the original cost of the asset, and (2) its probable lifetime. If the lifetime of a piece of property is (say) ten years, then an annual 10% depreciation rate, which would spread the cost over the entire ten-year lifetime, would seem to be "reasonable"; whereas, an annual 25% depreciation rate would be manifestly "*un*reasonable."

Again, in determining the "reasonable" amount of annual depreciation, there are several established methods for distributing the amount of the depreciation over the life of the asset and thus determining the annual amount of depreciation. It may be (*a*) a fixed annual percentage of the cost; or (*b*) an amount which decreases each year; or (*c*) ascertained by some periodical re-valuation; or (*d*) any one of several other well-known established methods. Each of these methods includes only (1) the initial cost, and (2) the lifetime of the asset, as the necessary factors in determining the "reasonable allowance" for depreciation. The word, "reasonable" refers to the rate of depreciation, or the amount of depreciation when determined by some established method, taken in connection with the cost of the property and its probable future lifetime. A "reasonable allowance" for depreciation, or a reasonable depreciation," **has no connection whatsoever with the taxpayer's "gross income," "net income" or any statutory definition of either.**

Although the Commissioner stipulated that $1,783.02 constituted a "reasonable allowance for depreciation" of the Rockford Life's furniture and fixtures for 1929, his *application* of the statute *took away* from the Rockford Life practically five-sixths of what the Commissioner *stipulated* was its reasonable allowance for depreciation for 1929.

The only method by which the decision of the C. C. A. (7th) can be sustained is (1) to disregard Congress's *un*qualified use of the word "property"; (2) to *qualify* "property" by adding to it a phrase *not* used by Congress, *i. e.* only such property as is used by the company in its "investment" business; but without any statutory or

other guide to define the "investment" part of the business; and (3) to arrive at the qualification just mentioned, not by anything expressed in the Statute, but by an *unjustified assumption* that Congress had omitted from taxation one part of the company's income, and taxed only another part of the income; and then, on top of that erroneous assumption, to pile another erroneous assumption *i. e.*, that Congress *never intended to allow depreciation* upon such part of the company's property as was used in the production of the (*erroneously assumed*) untaxed portion of income.

If any such unauthorized method can be used to determine the meaning of a statute, then there is no limit to the possible interpretations that can be put upon a simple, well understood English sentence which for many years had been construed and applied without any difficulty.

Conclusion.

The judgment of the C. C. A. (6th) in No. 689, *Independent Life* case should be *affirmed*.

The judgment of the C. C. A. (7th) in the *Rockford Life* case should be *reversed*.

WM. MARSHALL BULLITT,
Special Counsel.

JAMES A. NEWMAN,
General Counsel Independent Life Ins. Co.

C. K. WELSH,
General Counsel Rockford Life Ins. Co.

April 2, 1934.

SUPREME COURT OF THE UNITED STATES.

No. 689.—October Term, 1933.

Guy T. Helvering, Commissioner of Internal Revenue, Petitioner, *vs.* The Independent Life Insurance Company.	On Writ of Certiorari to the United States Circuit Court of Appeals for the Sixth Circuit.

[May 21, 1934.]

Mr. Justice Butler delivered the opinion of the Court.

This case involves the validity of deficiency assessments of income taxes made by the Commissioner against the life insurance company for 1923 and 1924. The 1921 Revenue Act (42 Stat. 261), § 244 (a) defines gross income of such companies as that received from interest, dividends and rents. Premiums and capital gains are excluded. Section 245 (a) directs that net income be ascertained by making specified deductions from gross income. These include four per cent. of the company's reserve, "(6) Taxes and other expenses paid during the taxable year exclusively upon or with respect to the real estate owned by the company . . ." and "(7) A reasonable allowance for the exhaustion, wear and tear of property, including a reasonable allowance for obsolescence". But it is provided, § 245 (b), that no deduction shall be made under paragraphs (6) and (7) "on account of any real estate owned and occupied in whole or in part by a life insurance company unless there is included in the return of gross income the rental value of the space so occupied. Such rental value shall be not less than a sum which in addition to any rents received from other tenants shall provide a net income (after deducting taxes, depreciation, and all other expenses) at the rate of 4 per centum per annum of the book value at the end of the taxable year of the real estate so owned or occupied". Provisions similarly worded and having the same meaning are contained in the Revenue Act of 1924, §§ 244, 245. 43 Stat. 289.

During 1923 and 1924 respondent owned a building of which it occupied part and rented part. Its tax return for each year in-

cluded in gross income the rents received for the space let and deducted the taxes, expenses and depreciation chargeable to the whole building. The result for 1923 was a net of $3,615.30 whereas four per cent. of book value amounted to $18,400. The result for 1924 was minus $14,629.76, four per cent. of the then book value being $19,770.32. The Commissioner, following § 245 (b) added to the rents received from lessees in each year a sum sufficient to make the net equal to the required four per cent. On that basis the amount of the deficiency for 1923 was $298.97 and for 1924 $1,115.65.[1] The Board of Tax Appeals held them direct taxes and therefore invalid. 17 B. T. A. 757. The Circuit Court of Appeals affirmed, one of the judges dissenting. 67 F. (2d) 470. Its decision conflicts with *Commissioner* v. *Lafayette Life Ins. Co.* (C. C. A.-7), 67 F. (2d) 209, and *Commissioner* v. *Rockford Life Ins. Co.* (C. C. A.-7) 67 F. (2d) 213.

The question for decision is whether the statutory provisions relied on violate the rule that no direct tax shall be laid unless in proportion to the census. Constitution, Art. I, § 9, cl. 4. In support of the decision below, respondent maintains that the "rental value" of the space occupied by it was included in net income and taxed and that the exaction is a direct tax on the land itself and void for lack of apportionment.

If the statute lays taxes on the part of the building occupied by the owner or upon the rental value of that space, it cannot be sustained for that would be to lay a direct tax requiring apportionment. *Pollock* v. *Farmers' Loan & Trust Co.*, 157 U. S. 429, 580, 581; 158 U. S. 601, 635, 637, 659. *Brushaber* v. *Union Pac. R. R.*, 240 U. S. 1, 16, 17. *Eisner* v. *Macomber*, 252 U. S.

[1] In 1923, rents were $73,620.48. Taxes, expenses and depreciation were $70,005.18. Book value was stipulated to be $460,000. The commissioner called the difference between $18,400 (4% of $460,000) and $3,615.30 ($73,620.48 — $70,005.18) or $14,784.70 the "value of space owned and occupied by company". That, added to rents received, amounted to $88,405.18. He then subtracted from gross income so increased the sum of permissible deductions, including the $70,005.18.

In 1924, rents were $71,289.21. Taxes, expenses and depreciation were $85,918.97. Book value was $494,257.97. The commissioner added $19,770.32 (4% of $494,257.97) and $14,629.76 ($71,289.21 — $85,918.97) and called the sum, $34,400.08, the "value of space owned and occupied by company". That, added to rents received, amounted to $105,689.29; and from gross income so increased were subtracted the deductions, including the $85,918.97.

189, 205. *Dawson* v. *Kentucky Distilleries Co.*, 255 U. S. 288, 294. *Bromley* v. *McCaughn*, 280 U. S. 124, 136. *Willcuts* v. *Bunn*, 282 U. S. 216, 227. The rental value of the building used by the owner does not constitute income within the meaning of the Sixteenth Amendment. *Eisner* v. *Macomber*, *supra*, 207. *Stratton's Independence* v. *Howbert*, 231 U. S. 399, 415, 417. *Doyle* v. *Mitchell Brothers Co.*, 247 U. S. 179, 185. *Bowers* v. *Kerbaugh-Empire Co.*, 271 U. S. 170, 174. *Taft* v. *Bowers*, 278 U. S. 470, 481, 482. *MacLaughlin* v. *Alliance Ins. Co.*, 286 U. S. 244, 249, 250. Cf. *Burk-Waggoner Assn.* v. *Hopkins*, 269 U. S. 110, 114.

Earlier Acts taxed life insurance companies' incomes substantially the same as those of other corporations. Because of the character of the business, that method proved unsatisfactory to the Government and to the companies. The provisions under consideration were enacted upon the recommendation of representatives of the latter. As rents received for buildings were required to be included in gross and expenses chargeable to them were allowed to be deducted, it is to be inferred that Congress found—as concededly the fact was—that the annual net yields from investments in such buildings ordinarily amounted to at least four per cent. of book value. Where an insurance company owns and occupies the whole of a building, it receives no rents therefor and is not allowed to deduct the expenses chargeable to the building. Where part is used by the company and part let, the rents are required to be included in the gross, but expenses may not be deducted unless, if it be necessary, there is added to the rents received an amount to make the total sufficient, after deduction of expenses, to leave four per cent. of book value. All calculations contemplated by § 245 (b) are made subject to that limitation. Congress intended that the rule should apply only where rents exceed such four per cent. Where they are less than that, addition of the prescribed rental value and deduction of expenses operate to increase taxable income.[2] The classification is not without foundation.

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[2]Take for example: book value of building, $1,000,000; 4% of book value, $40,000; rents received, $30,000; expenses, $60,000. If the calculation prescribed by § 245 (b) is not made, taxable income is $30,000.

The calculation prescribed by § 245 (b) follows: rents, $30,000, plus "rental value", $70,000 (expenses, $60,000, minus rents, $30,000, plus the 4%—$40,000) amounts to $100,000, less expenses, $60,000, leaves taxable income, $40,000. Cf. Art. 686, Treasury Regulations, 62 and 65.

The company is not required to include in gross any amount to cover rental value of space used by it, but in order that, subject to the specified limitation, it may have the advantage of deducting a part of the expenses chargeable to the building, it is permitted to make calculations by means of such an addition. The statute does not prescribe any basis for the apportionment of expenses between space used by the company and that for which it receives rents. The calculation indicated operates as such an apportionment where the rents received are more than four per cent. of book value, but less than that amount plus expenses.[3] In such cases the addition, called rental value of space occupied by the company, is employed to permit a deduction on account of expenses. That, as is clearly shown in the dissenting opinion, *supra*, p. 473, is the arithmetical equivalent of lessening the deduction by the amount of the so-called rental value.

Respondent cites *Nat'l Life Ins. Co.* v. *United States*, 277 U. S. 508, but the distinction between that case and this one is fundamental and obvious. There the effect of the statutory deduction was to impose a direct tax on the income of exempt securities, amounting to taxation of the securities themselves. We held that the tax imposed, so far as it affected state and municipal bonds, was unconstitutional and that, in so far as it affected United States bonds, it was contrary to the statute. In *Denman* v. *Slayton*, 282 U. S. 514, we held the taxpayer not entitled to deduct the interest on debts incurred to purchase securities the interest on which was exempt. The opinion points out the distinction between that exclusion from deductions and the taxation of exempt securities condemned in *Nat'l Life Ins. Co.* v. *United States*. As shown above, the prescribed calculation, § 245 (b), is in substance a diminution or apportionment of expenses to be deducted from gross income under the circumstances specified. See *Anderson* v. *Forty-Two Broadway Co.*, 239 U. S. 69.

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[3]Take for example: book value of building, $1,000,000; 4% of book value, $40,000; rents received, $50,000; expenses, $60,000.

On that basis the calculation is: rents, $50,000 plus "rental value", $50,000 (expenses, $60,000 minus rents $50,000 plus 4%, $40,000), amounts to $100,000 less expenses $60,000 leaves taxable income $40,000. Deduction of expenses operates to reduce taxable income by $10,000.

Assume rents received were $100,000. No rental value need be added. Deducting expenses, $60,000, leaves taxable income $40,000.

Unquestionably Congress has power to condition, limit or deny deductions from gross income in order to arrive at the net that it chooses to tax. *Burnet* v. *Thompson Oil & Gas Co.*, 283 U. S. 301, 304. *Stanton* v. *Baltic Mining Co.*, 240 U. S. 103. *Brushaber* v. *Union Pac. R. R., supra*, 23-24. It is clear that the provisions under consideration do not lay a tax upon respondent's building or the rental value of the space occupied by it or upon any part of either.

Reversed.

Mr. Justice McReynolds is of opinion the judgment should be affirmed.

A true copy.

Test:

Clerk, Supreme Court, U. S.